TRAFFORD COUNCIL

Report to:	**Accounts & Audit Committee 5 February 2013** **Executive & Council Meetings 20 February 2013**
Report for:	**Decision**
Report of:	**The Executive Member for Finance and Director of Finance**

Report Title

TREASURY MANAGEMENT STRATEGY 2013/14 – 2015/16

Summary

This report presents the:-

- expected treasury operations for this period,
- risks facing local authorities in Treasury Management operations,
- measures to minimise these risks and
- prudential indicators for 2013/14 – 2015/16

In response to the continuing stagnant world economic climate, the recommended strategy will remain similar to that approved last year with only a minor change requested to be implemented to the Investment criteria as highlighted in Appendix 1.

Recommendation(s)

That the Executive and Accounts & Audit Committees recommend to Council the 3 key elements of this report for approval :-

- policy on debt strategy for 2013/14 to 2015/16 as set out in section 3,
- investment strategy for 2013/14 to 2015/16 as set out in section 5,
- Prudential Indicators and limits including the Authorised Limit and Operational Boundary as required by section 3(1) of the Local Government Act 2003, Minimum Revenue Provision Statement and Investment criteria as detailed in Appendix 1.

Contact person for access to background papers and further information:

Name: Graham Perkins
Extension: 4017

Background papers: None

Relationship to Policy Framework / Corporate Priorities	Value for Money
Financial	The treasury management strategy will aim to maximise investment interest and reduce interest payable on debt, whilst minimising the risk to the Council.
Legal Implications:	Actions being taken are in accordance with legislation, CIPFA Treasury Management Code of Practice.
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Staffing/E-Government/Asset Management Implications	Not applicable
Risk Management Implications	The overriding aim will always be to minimise risk and in respect of this the annual strategy report will therefore remain a cornerstone of the treasury management decision making process.
Health and Safety Implications	Not applicable

Other Options

This report has been produced in order to comply with Financial Procedures and relevant legislation and provides a plan of action for the period 2013-14 to 2015-16 which is flexible enough to take account of changes in financial markets.

Consultation

Advice has been obtained from Sector, the Council's external advisors.

Reasons for Recommendation

The Financial Procedure Rules incorporating the requirements of the revised CIPFA Prudential Code and the CIPFA Treasury Management Code. These consider that the annual strategy report is an essential control over treasury management activities and one whereby Members approve the parameters under which officers will operate. In addition The Local Government Act 2003 requires that the Council approves an annual borrowing limit (the Authorised Limit) and CLG Guidance an annual investment strategy (setting out the limits to investment activities).

Key Decision

This will be a key decision likely to be taken in: February 2013
This is a key decision currently on the Forward Plan: Yes

Treasury Management Strategy – Key Points

This report outlines the expected treasury activities for the forthcoming 3 years and has been prepared in accordance with the Council's Financial Procedure Rules. Additional treasury management reports are produced during the course of the year reporting actual activity for the preceding year and a mid-year update.

Economic situation (Section 2)

The world economic climate continues to remain stagnant with growth prospects forecasted to remain weak. Consumer spending, the usual driving force of any recovery, is likely to remain under pressure due to falling real incomes, repayment of personal debt and employment fears.

During 2012/13 the main economic events were;

- continuing debt crisis within the Eurozone - several countries received additional emergency financial bailouts,
- a delay in corrective action being put into place to address the worsening economic situation in the US due to the Presidential elections,
- UK economy remains fragile although both inflation and unemployment rates started to show signs of improvement and
- expectations of a worldwide recovery, led by the emerging markets of China, India and Brazil, did not materialise.

As a consequence of these factors and in order to maintain the Council's risk exposure to a minimum, investments were placed for an average period of 2 months and no new debt was taken in 2012/13.

Debt (Section 3)

The Council policy of not taking on any additional external loans in order to fund its borrowing requirement will result in it being under borrowed by £49m at 31 March 2013. This approach has been adopted as a result of continuing risks associated with investment counterparties and the large difference between debt costs and investment returns and has been widely adopted by councils throughout the country

Any debt restructuring exercises will be undertaken in order to produce revenue savings.

Investments (See Section 5 and Appendix 1)

The primary principle governing the Council's investment criteria remains unchanged as that previously adopted of firstly security of capital, then liquidity of its cash flows and finally yield.

The Council is required to agree the lending criteria, which is primarily determined by credit ratings issued by all 3 major credit rating agencies as detailed at Appendix 1. *The only recommended change to that previously agreed by Council in February 2012 relates to the increase in the maximum duration amounts can be lent to those UK institutions deemed to be pivotal to the UK monetary system.*

Prudential Indicators and limits (Section 7 and Appendix 1)

The Council is required to approve a set of Prudential Indicators and limits which ensure the Council's capital expenditure plans and borrowing remain robust, prudent, affordable and sustainable. These are detailed at Appendix 1 for Member approval.

1. Background

Please note a glossary of all abbreviations appears at Appendix 6 for reference.

1.1 Treasury management is an important part of the overall financial management of the Council's affairs and in accordance with the CIPFA Code of Practice is defined as:

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

1.2 The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity.

1.3 The Council's treasury activities are strictly regulated by statutory requirements, and these are detailed for reference at Appendix 2.

1.4 In November 2012, CIPFA amended the Prudential Code to reflect the introduction of a new Prudential Indicator "Gross debt and the Capital Financing Requirement". The purpose of this new indicator is to ensure that external debt over the medium term will only be for a capital purpose and will not exceed the total of the Capital Financing Requirement.

1.5 The Council uses Sector as its treasury management advisors who provide a range of services from technical support on treasury matters to the supply of credit ratings as issued by the three main credit rating agencies.

1.6 Whilst the advisors provide support to the internal treasury management function, the Council recognises that the final decision on all treasury management matters remains with the organisation at all times. This service is subject to regular review.

1.7 The Council recognises the importance of ensuring that all Members and staff involved in the treasury management function receive adequate training and are fully equipped to undertake the duties and responsibilities allocated to them by ensuring that;

Members will continue to have access to training which will be relevant to their needs & responsibilities;

Officers will attend courses / seminars presented by CIPFA, LGC, Advisors & any other suitable professional organisation in accordance with Council policy on this issue.

1.8 Excluded from this report are the activities carried out by the Council's schools which operate within separate criteria as stipulated by the Director of Finance and in accordance with the Council's Financial Procedure Rules.

2. Economic & Interest Rate forecast

2.1 In the current global financial climate economic forecasting, with any degree of accuracy, continues to remain difficult with analysts agreeing that any prospects of a sustained recovery remains fragile. This situation is set to remain for some time particularly as consumers, corporates and banks continue to focus on reducing their debt levels, rather than incurring any further additional spending. This historically has been the main catalyst to any recovery and it is unlikely the UK economy will begin any sustained recovery until the consumer sector feels more optimistic and real household incomes improve.

2.2 A summary of the main economic headlines occurring in 2012 are outlined below;

UK economy-

- the Government's austerity measures, aimed at getting the public sector deficit into order by 2014-15, was extended to 2016-17 in the Chancellor's Autumn statement presented to Parliament in December 2012. Achieving this target however is dependent on a number of factors being met such as the Eurozone economy growing at a reasonable pace and the UK economy growing at expected levels, which would allow for increased tax receipts together with a reduction in welfare benefit payments;
- Unemployment benefit claimants fell with employment rates rising to their highest since records began in 1971;
- Preliminary growth figures issued for quarter 4 showed that the economy reduced by 0.3%, with both consumer confidence levels and manufacturing output remaining weak. As a consequence of this, growth for 2012 remained flat and market commentators are now suggesting that the possibility of a "triple dip" could be encountered;
- The UK continued to be seen as a safe haven for foreign investors and as a consequence of this, the Government benefited from low borrowing costs;
- Banks continue to realign their balance sheets to more manageable levels and consequently the availability of credit continues to remain tight. The Bank of England's Funding for Lending scheme, launched in August 2012 of encouraging the availability of cheap funding to be released from the banks to small businesses and consumers, can now be seen to be having its desired effect on the economy as short term market investment interest rates have reduced during the past few months. Quantitative Easing (QE) was increased again by £50bn in July 2012 to a total of £375bn. Bank rate remained at 0.5%;
- Consumer Purchases Index (CPI) fell sharply during 2012 from its peak of 5.2% in September 2011 to 2.7% in November 2012, although cost pressures from the energy sector may see future pressures.

Eurozone –

- the sovereign debt crisis subsided during the year following the European Central Bank's pledge to buy unlimited amounts of bonds of those countries asking for a bailout,
- Spain & France had their sovereign credit rating downgraded with other countries being placed on a Negative Rating Outlook (this indicates the direction a rating may move over a 1 – 2 year period should current trends continue).

US –

- the economy, although at a disappointing low level, continued to grow, responding to the Federal Reserve combined actions of undertaking a huge programme of Quantitative Easing (QE) and committing to a policy of maintaining low interest rates into 2015,
- Unemployment levels fell although this trend may reverse as a result of businesses retaining any surplus funds in readiness for the actions

which the President will need to take in order to address the country's budget deficit,

- The key difficulty will be the Presidential response to the "fiscal cliff" which will see $600bn of stimulus being taken out of the economy in the first year and still needs to be addressed despite January's vote postponing the introduction of these measures,
- The housing market now looks to have bottomed with house prices now on the increase.

Emerging markets –

hopes for a broad based recovery have, receded due to the increasing concerns with the Chinese economy may be heading for a hard landing rather than a gradual slow down as previously predicted.

2.3 As a consequence of the above situations it is widely predicted that the UK economy will, remain relatively fragile and currently forecasts for several key areas are shown below;

UK bank rate, currently at 0.5%, is not expected to move until March 2015, at the earliest,

Additonal Quantitative Easing is likely to take place, if the economy performs worse than expected,

Consumer Price Inflation will fall from 2.7%, (at the end of quarter 4 2012), to the 2% Government target level within two years, although energy price rises may upset this objective,

Growth is expected to remain fragile, with the possibility of negative growth in future.

2.4 The UK continues to enjoy an AAA sovereign credit rating however the rating agencies have already stated that they will not hesitate to downgrade this should the economy not perform in line with the Government's debt reduction plans. The impact of such a downgrade, should it happen, is not expected to have a major impact on bond prices given the state of economies elsewhere, especially in the Eurozone.

2.5 Sector, the Council's external treasury management advisors, has produced a set of interest rate forecasts up to March 2016 and these are shown in the table below;

Annual Average %	**Bank Rate**	**Investment Rates**		**Borrowing Rates**	
		3 month	**1 year**	**5 year**	**25 year**
2012/13	0.50	0.50	1.00	1.55	3.80
2013/14	0.50	0.50	1.00	1.65	3.80
2014/15	0.55	0.70	1.20	1.90	4.10
2015/16	1.35	1.50	1.95	2.60	4.70

2.6 As a result of this economic position the Council will take a cautious approach to its treasury strategy during this period.

3. Debt Strategy 2013/14 – 2015/16

3.1 The Council maintains an under-borrowed position. This has resulted from the underlying borrowing need arising from the capital programme and historic capital decisions (the Capital Financing Requirement, CFR), not been fully funded by taking on external debt. Instead cash supporting the Council's reserves, balances and cash flow Has been used to finance this requirement.

3.2 The Council's forecasted under-borrowed position is set to peak at £49m, as at 31 March 2013, and thereafter is set to fall as a result of

a move from an annual positive capital financing requirement to an negative one (this is as a result of the annual minimum revenue provision set aside to pay down the CFR being greater than the actual new loan requirement) and

existing external loans maturing not being replaced.

3.3 The strategy of not undertaking any external borrowing which the Director of Finance, under delegated powers has adopted, is set to continue for the foreseeable future. This prudent approach has been widely implemented by the majority of councils throughout the country during the current climate of low investment returns and high risk of counterparty default.

3.4 As a result of the above action the Council's total external debt levels will fall from the current level of £100.5m to £93.2m by 31 March 2016.

3.5 In addition to this debt, the Council is also responsible for a further £1.2m of loans which are administered by Tameside Borough Council on behalf of all the 10 Greater Manchester Authorities. This follows the conversion in February 2010, of loans previously held on behalf of Manchester International Airport into an equity rated instrument.

3.6 As short term borrowing rates will be cheaper than longer term fixed interest rates, there may be potential opportunities in the future to generate revenue savings by switching from long term debt to short term debt. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

3.7 Any interest savings generated from undertaking a debt restructuring exercise, will however need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred) to ensure it represents value for money.

3.8 The Council is required to set its limits for external debt for 2013/14 to 2015/16 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code before the commencement of each financial year. **These limits are detailed at Appendix 1 for Council approval.**

3.9 The Council has some flexibility to borrow funds in advance, for use in future years and the Director of Finance may do this under delegated powers where, for instance, a sharp rise in interest rates is expected. Any decision to borrow in advance will be considered carefully to ensure that value for money can be demonstrated and the subsequent reporting to Members will be undertaken through the mid-year or annual reporting mechanism.

3.10 The Director of Finance will adopt a cautious approach to any such borrowing and this will be undertaken within the constraints below;

no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period is to be taken in this manner and

borrowing only up to a maximum 12 months in advance of need.

3.11 A breakdown of the Council's expected debt maturity profile as at 31 March 2013 is provided at Appendix 4 for reference which also shows, in accordance with the Code of Practice, the potential first date the lending banks could amend the rate of interest for the market loans.

4. Minimum Revenue Provision Strategy

4.1 The Council is required to set aside an amount each year for the repayment of debt (by reducing the CFR), through a revenue charge called the Minimum Revenue Provision (MRP). In addition the Council is also allowed to undertake additional voluntary payments (VRP).

4.2 CLG regulations have been issued which require 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 requested to approve the MRP statement as detailed at Appendix 1.**

5. Investment Strategy

5.1 The primary principle governing the Council's investment criteria is the security of its investments and in order to comply with this, the Council's investment priorities will therefore remain unchanged as that previously adopted;

security of capital,

liquidity of its cash flows and

yield.

5.2 In order to minimise the risk of a counterparty defaulting, the Director of Finance will maintain, as in previous years, a list comprising of high creditworthy counterparties with which the Council can invest funds based on the lowest common denominator method. This approach involves considering the credit ratings, issued by all three of the main rating agencies (Fitch, Moody's and Standard and Poor's) and defaulting to the lowest equivalent rating in order to produce a counterparty list.

5.3 To enable a counterparty to be included on this list, credit ratings from at least two of the three independent rating agencies needs to be assigned to an institution and that these must meet all the minimum levels required by the Council as shown at Appendix 1. This is in compliance with CIPFA's Treasury Management Code of Practice.

5.4 Information on credit ratings is supplied electronically by the Council's treasury advisors on a real time basis and action is implemented immediately when appropriate. For instance should a counterparty be issued with a negative rating watch, which results in its credit ratings failing to meet the minimum required by the Council, then this counterparty will be suspended from further use.

5.5 A full explanation of the credit ratings determining the counterparties which the Council will choose can be found at Appendix 3.

5.6 The criteria for providing a list of high quality investment counterparties (both Specified and Non-specified), and reducing exposure of the Council's investments by country, group and sector are explained in more detail at Appendix 3 together with time and value limits.

5.7 Whilst the Council's criteria relies primarily on the application of credit ratings to provide a group of appropriate counterparties for officers to use, additional operational market information will be applied in accordance with the Code of Practice before making any specific investment decision. This additional market information is detailed for Members reference at Appendix 3.

5.8 The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded and will be limited to the Prudential Indicator detailed at Appendix 1.

5.9 In the normal course of the Council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

5.10 The criteria for choosing counterparties as set out at Appendix 1 provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria, the Director of Finance may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval should any exceptional market conditions be encountered. These restrictions would remain in place until the banking system returned to "normal" conditions. Similarly the time periods for investments will be restricted.

5.11 The UK banks are perceived to be more secure than those within the Euro zone, due to their stronger credit ratings and balance sheets. **In order to further safeguard the Council's investments, it is recommended that the maximum duration for which investments can be invested with those UK institutions (deemed to be pivotal to the UK monetary system and which are actively in the money market), be increased as indicated at Appendix 1.**

5.12 The minimum criteria for providing a list of high quality investment counterparties, instruments and limits to be applied are highlighted at **Appendix 1** and Council is requested to approve these requirements.

6. Investment Risk Benchmarking

6.1 The Code of Practice and CLG Investment Guidance require that appropriate security and liquidity benchmarks are considered and reported to Members and these are explained in more detail in Appendix 3.

6.2 These benchmarks are simple guides to maximum risk (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. Their purpose is to assist officers to 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 to Members, with supporting reasons in the Mid-Year or Annual Report. For reference these benchmarks will be;

Security - for each individual year the security benchmark when compared to historic default rates are not to exceed:

1 year investments	2 year investments	3 year investments
0.09%	**0.04%**	**0.14%**

Liquidity - In respect of this the Council seeks to maintain;

- Bank overdraft of £0.5m,
- Weighted Average Life (WAL) benchmark for 2013/14 is set at 6 months, with a maximum of 3 years,
- Liquid short term deposits of at least £20m are available with a week's notice

Yield benchmarks are currently used to assess investment performance and internal returns are required to achieve above the 7 day LIBID rate.

7. Prudential Indicators

7.1 A number of prudential indicators have been devised for both the treasury management and capital operations. These are designed to assist managing risk and reducing the impact of an adverse movement in interest rate as well as ensuring that the Council's capital expenditure plans are prudent, affordable and sustainable. These indicators have been set in order that they are not too restrictive thereby impairing the opportunities to reduce costs and reflect the capital programme proposals, included within the main budget report.

7.2 Members are requested to approve the prudential indicators for both the Council's capital expenditure and treasury management activities as detailed at **Appendix 1**.

8. Recommendations

That the Executive and Accounts & Audit Committee recommend to Council the key elements of this report for approval;-

the policy on debt strategy for 2013/14 to 2015/16 as set out in section 3;

the investment strategy for 2013/14 to 2015/16 as set out in section 5;

the Prudential Indicators and limits including the Authorised Limit (as required by section 3(1) of the Local Government Act 2003), The Minimum Revenue Provision Statement and Investment criteria as detailed in Appendix 1.

Finance Officer Clearance *……ID………..*

Legal Officer Clearance *…MJ………*

Director of Finance Signature **[Signature appended in hard copy.]**

KEY ELEMENTS FOR COUNCIL APPROVAL

In accordance with CLG Guidance, the CIPFA Prudential Code and the CIPFA Code of Practice on Treasury Management each council is required to set, before the commencement of each financial year, Treasury Management Prudential Indicators and limits, a Minimum Revenue Provision Statement and Investment criteria.

The Executive and Accounts and Audit Committee are requested to recommend that Council approve these for the period 2013/14 – 2015/16 as detailed below;

PRUDENTIAL INDICATORS AND LIMITS

Treasury Management - (changes annually)

In accordance with the CIPFA Prudential code, the Council is required to produce prudential indicators and limits reflecting the expected capital activity regarding its capital investment programme. These have an impact on the Council's treasury management activities and the Council is required to approve the prudential indicators and limits affecting treasury management performance as shown below;

Treasury Management Prudential Indicators	2012/13 estimate £m	2013/14 estimate £m	2014/15 estimate £m	2015/16 estimate £m
(1) Upper Limits – Fixed interest rate exposure (interest costs)	**3.4**	**3.6**	**3.1**	**2.4**
(2) Upper Limits – Variable interest rate exposure (interest costs)	**1.7**	**1.9**	**3.0**	**3.1**
Upper Interest Limits – identifies the maximum limit for both fixed and variable interest rates exposure based upon the Council's debt position net of investments (debt interest payable less investment interest receivable).				
(3) Authorised Limit for External debt				
- External debt (01.04)	125	120	120	115
- Other long term Liabilities (PFI)	7	6	6	6
Total	**132**	**126**	**126**	**121**
Authorised external debt limit - maximum level of external debt that the authority will require to cover all known potential requirements and includes headroom to cover the risk of short-term cash flow variations that could lead to a need for temporary borrowing. This limit needs to be set or revised by Council and is the statutory limit determined under section 3(1) of the Local Government Act 2003.				
(4) Operational Boundary Limit for External debt				
- External debt (01.04)	101	101	97	95
- Other long term Liabilities (PFI)	7	6	6	6
Total	**108**	**107**	**103**	**101**
Operational boundary - calculated on a similar basis as the authorised limit but represents the likely level of external debt that may be reached during the course of the year excluding any temporary borrowing and is not a limit.				

(5) Upper limit for sums invested over 364 days	**50**	**50**	**40**	**30**
Upper Limit for sums invested for over 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.				
(6) Gross debt and Capital Financing Requirement				
-External debt (01.04)	101	101	97	95
-Other long term Liabilities (PFI)	7	6	6	6
Gross debt	108	107	103	101
-C.F.R.	149	144	137	133
Excess C.F.R.	**41**	**37**	**34**	**32**
Gross Debt and the Capital Financing Requirement – this new indicator incorporated into the Prudential code in November 2012 is to be implemented from 1 April 2013 and reflects that over the medium term, debt will only be for capital purposes. The Director of Finance will ensure that all external debt does not exceed the capital financing requirement with any exceptions being reported to Council.				

MATURITY STRUCTURE of BORROWING 2013/14 to 2015/16		
	Lower limit %	**Upper limit %**
Under 12 months	0	70
12 months to 2 years	0	25
2 years to 5 years	0	25
5 years to 10 years	0	25
10 years to 20 years	0	25
20 years to 30 years	0	25
30 years to 40 years	0	25
40 years and above	0	25

Maturity Structure of Borrowing – these gross limits are set to reduce the Council's exposure to large sums falling due for refinancing and this indicator reflects the next date on which the lending bank can amend the interest rate for the Lender Option Borrower Option loans.

Capital – (changes annually)

Capital Prudential Indicators	**2012/13 Estimate £m**	**2013/14 Estimate £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**
Capital Expenditure	**63.9**	**38.7**	**27.0**	**11.3**
Capital expenditure - the table above shows the estimated capital expenditure to be incurred for 2012/13 and the following three years. This indicator has been updated following the Accounts & Audit meeting on 5 February 2013 in order to reflect the latest spend profile of the Council's capital programme.				

Capital Financing Requirement as at 31 March	**149.3**	**144.1**	**137.3**	**132.7**
Capital Financing Requirement (CFR) - this reflects the estimated need to borrow for capital investment (i.e. the anticipated level of capital expenditure not financed from capital grants and contributions, revenue or capital receipts). The actual calculation of the CFR is derived from the balance sheet as at 31/3/12 including estimates of the end of year position for the current and future years.				
Financing Cost to Net Revenue Stream	**6.2%**	**7.0%**	**7.6%**	**7.2%**
Financing costs to net revenue stream - this indicator shows the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the Council's net revenue stream.				
Incremental Impact on Band D Council Tax (£)	**5.25**	**13.66**	**0.00***	**0.00***
Incremental impact on band D council tax – reflects the incremental impact on the Council Tax arising from new borrowing undertaken in order to finance the capital investment decisions taken by the Council during the budget cycle. The figures above, reflects the movement away from borrowing to grant funding for future years spend.				

*this reflects that the Capital Financing Requirement is set to reduce in 2013/14 as no further borrowing is expected to be undertaken.

All the prudential indicators are monitored on a regular basis. If the situation arises that any of the prudential indicators appear that they will be breached for a sustained period, then this will be reported to the Council at the earliest opportunity.

<u>MINIMUM REVENUE PROVISION - </u>(no change)
In accordance with C.L.G. Guidance, the Council shall determine for the current financial year, an amount of minimum revenue provision that it considers to be prudent and submit an MRP Statement setting out its policy for its annual MRP to Council for approval. The following MRP Statement has been prepared in accordance with the Council's accounting procedures as stated in the annual Statement of Accounts publication and is recommended for approval:

Capital expenditure supported by external borrowing approvals -, the MRP policy will follow the existing practice outlined in former C.L.G. Guidance, i.e. 4% of the Capital Financing Requirement;

Capital expenditure supported by prudential borrowing -, the policy will be based on the estimated life of the assets once operational with MRP charged on a straight line basis or annuity basis in accordance with the Guidance;

MRP regarding PFI schemes and leases shown on the balance sheet will be based on the amount of the principal lease repayment included within the annual unitary payments made;

For expenditure that does not create an asset, or following the use of a Capitalisation Direction, provision will be made over a period not exceeding 20 years, in accordance with Guidance.

In May 2012, the Council participated in the national Local Authority Mortgage Scheme using the cash backed option with Lloyds TSB. This involved the Council placing a five year deposit totalling £2m with the bank matching the five year life of the indemnity. This deposit provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity and once received will be classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. Interest earned on this deposit is paid annually and in order to keep to a minimum any future potential call on the Council's resources due to mortgage defaults, a proportion of interest earned, net of cash flow impact on the £2.0m advanced, is placed into a reserve to be used as a first call on any future liabilities. At the end of the indemnity period all surplus funds held in this reserve would be made available for general purposes.

INVESTMENT CRITERIA – (recommended changes as highlighted)
The minimum criteria for providing a list of high quality investment counterparties is highlighted in the categories below and these are to be applied for both Specified and Non-specified investments;

	Fitch (or equivalent) – Long Term	Maximum Group Limit	Maximum Time Limit
Category 1 – All UK or Non UK banks and building societies domiciled in a country which has a minimum Sovereign long term rating of AA and individual credit rating issued by Fitch, Moody's and Standard and Poor's of: Short Term – Fitch F1 or equivalent Long Term – Fitch A- or equivalent Viability / Financial Strength – C (Fitch / Moody's only) Support – 3 (Fitch only).	A- to A+ AA- To AAA	£5m £20m	1yr 3yrs
Category 2 – UK Banks part nationalised -	-	£20m	3yrs
Category 3 – The Council's own banker if the bank falls below the above criteria.	-	£5m	1yr (current limit 3mth)
Category 4 – Money Market Funds – must be AAA credit rated UK Government (including treasury bills, gilts and the DMO) Local Authorities Supranational Institutions Corporate bonds (Manchester International Airport only)	-	£20m	3yrs

Specified and Non Specified Investments – (recommended changes as highlighted)

In accordance with the Code of Practice, the Council is required to set a criteria which identifies its investments between Specified and Non Specified investments and these are classified as follows;

Specified investments are high security and high liquidity investments with a maturity of no more than a year 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 considered low risk assets where the possibility of loss of principal or investment income is small. A maximum of 100% can be held under this definition,

Non specified investments are any other type of investment not defined as specified above with the maximum permitted to be held in this classification detailed in Appendix 1 including Manchester Airport Shares at a historical cost of £10.2m and

Local Authority Mortgage Scheme. Under this scheme, which is designed for first time buyers to be able purchase a property in the area, the Council is required to place funds of £2m with Lloyds TSB for a period of 5 years. This is classified as being a service investment, rather than a treasury management investment and is therefore outside of the specified / non specified categories.

All Investments will be undertaken in Sterling in the form of Term Deposits, Money Market Funds, or Certificates of Deposits unless otherwise stated below,

Specified Investments

Investment	Maximum Maturity
The UK Government including Local Authorities, Debt Management Office, UK Treasury Bills or gilts with less than one year to maturity.	1 Year
Supranational bonds of less than one year duration	1 Year
Pooled investment vehicles that have been awarded a AAA credit rating by Fitch, a credit rating agency, such as money market funds	1 Year
An institution that has been awarded a high short term credit rating (minimum F1 or equivalent) by a credit rating agency, such as a bank or building society.	1 Year

Non-Specified Investments

Investment	Maximum Maturity
Multilateral development bank bonds - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). The security of interest and principal on maturity is on a par with the Government and so are very secure, and these bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may	3 Years

rise or fall before maturity and losses may accrue if the bond is sold before maturity.	
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 value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	3 Years
The Council's own bank if it fails to meet the basic credit criteria.	1 Year (current limit 3 month)
UK Banks which have significant Government holdings	3 Years (current limit 1 Year)
Any bank or building society which meets the minimum long term credit criteria detailed in Appendix 1, for deposits with a maturity of greater than one year.	3 Years
The UK Government including Local Authorities, Debt Management Office, UK Treasury Bills or Gilts	3 Years
Share capital or loan capital in a body corporate – The use of these instruments maybe deemed to be capital expenditure, and as such maybe an application (spending) of capital resources. It is envisaged this facility will apply to the Manchester International Airport share holding which the Council holds at a historical value of £10.2m as reported in the 2011/12 statement of accounts. It is not envisaged that this type of investment will be undertaken in the future.	3 Years
Manchester Airport Group – This is in response to the restructuring of the airports existing debt and is included for clarity and transparency purposes only.	Term of loans

STATUTORY FRAMEWORK

Local Government Act 2003

In accordance with the Local Government Act 2003 (and supporting regulations and guidance) each Council must before the commencement of each financial year, produce a report fulfilling three key requirements as stipulated below;

The debt strategy in accordance with the CIPFA Code of Practice on Treasury Management (section 3);

The investment strategy in accordance with the Communities and Local Government (C.L.G.) investment guidance (section 5);

The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities (Appendix 1).

CIPFA Code of Practice

The Council's treasury activities are strictly regulated by statutory requirements in conjunction with a professional code of practice (the CIPFA Treasury Management Code of Practice). This Council adopted the Code of Practice on Treasury Management on 24 April 2002 and followed recommended practices by considering an annual Treasury Management Strategy before the commencement of each financial year. These Codes are revised from time to time and the Council complies with any revisions.

Investment Guidance

The C.L.G. issued Investment Guidance in March 2010, and this forms the structure of the Council's policy below,

The strategy guidelines for decision making on investments, particularly non-specified investments.

Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.

Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The principles to be used to determine the maximum periods for which funds can be committed.

INVESTMENT CREDIT AND COUNTERPARTY RISK MANAGEMENT
(No change)

The Council receives credit rating advice from its treasury management advisors, as and when ratings change and counterparties are checked promptly to ensure it complies with the Council's criteria. The criteria used are such that any minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria, or those on the minimum criteria placed on negative Credit watch, will be removed from the list immediately, and if required new counterparties which meet the criteria will be added to the list.

		Credit Rating Agency		
Classification	**Description**	**Fitch (Minimum)**	**Moody's (Minimum)**	**Standard & Poors (Minimum)**
Short Term	Ensures that an institution is able to meet its financial obligations within 12 months	F1 (Range **F1+, F2 A** to **D**)	P1 (Range **P1** to **P3**)	A1 (Range **A-1,** to **C**)
Long Term	Ensures that an institution is able to meet its financial obligations greater than 12 months	A- (Range **AAA** to **D**)	A3 (Range **AAA** to **C**)	A- (Range **AAA** to **CC**)
Viability / Financial Strength	Assess how an institution, in the event of financial difficulty, would be viewed if it were entirely independent and could not rely on external support.	C (Range **A** to **E**)	C (Range **A** to **E**)	N/a
Support	Indicates state support would be forthcoming in the event of financial difficulty	3 (Range **1** to **5**)	N/a	N/a

Investment Counterparty information.

Whilst the Council's Investment counterparty is prepared primarily using credit rating information additional market information is required to also be considered. The information below will also be considered when undertaking investments;

Credit default swaps - CDS were created in 1997 and are a financial instrument for swapping the risk of debt default. Essentially the owner of the position would enter into an agreement with a third party who would receive a payment in return for protection against a particular credit event – such as default. Whilst absolute prices can be unreliable, trends in CDS spreads do give an indicator of relative confidence about credit risk.

Equity prices – like CDS prices, equities are sensitive to a wide array of factors and a decline in share price may not necessarily signal that the counterparty in question is in difficulty.

Interest rates being paid - If a counterparty is offering an interest rate which is out of line with the rest of the market this could indicate that the investment is likely to carry a high risk.

Information provided by management advisors – this is may include some information detailed above together with weekly investment market updates.

Market & Financial Press information – information obtained from the money market brokers used by the Council in respect of interest rates & Counterparties will also be considered.

Investment Limits

In order to safeguard the Council's investments and in addition to the information shown at Appendix 1 due care will be taken to consider country, group and sector exposure as follows;

The country selection will be chosen by the credit rating of the Sovereign state as shown at Appendix 1 and no more than 40% of the Council's total investments will be directly placed with non-UK counterparties at any time;

limits in the table below will apply to Group companies (e.g. a group equates to Royal Bank of Scotland / Nat West);

Sector limits will be monitored regularly for appropriateness.

Investment Risk benchmarking

Security and liquidity benchmarks are central to the approved treasury strategy through the counterparty selection criteria and proposed benchmarks for these are set out below.

Security - In respect of benchmarking, assessing security is a much more subjective area to measure. 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 Poor's). Whilst this approach addresses the security considerations, benchmarking levels of risk is more difficult. A 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 below shows average defaults for differing periods of investment grade products for each Fitch/Moody's and Standard and Poors long term rating category over the period 1990 to 2011.

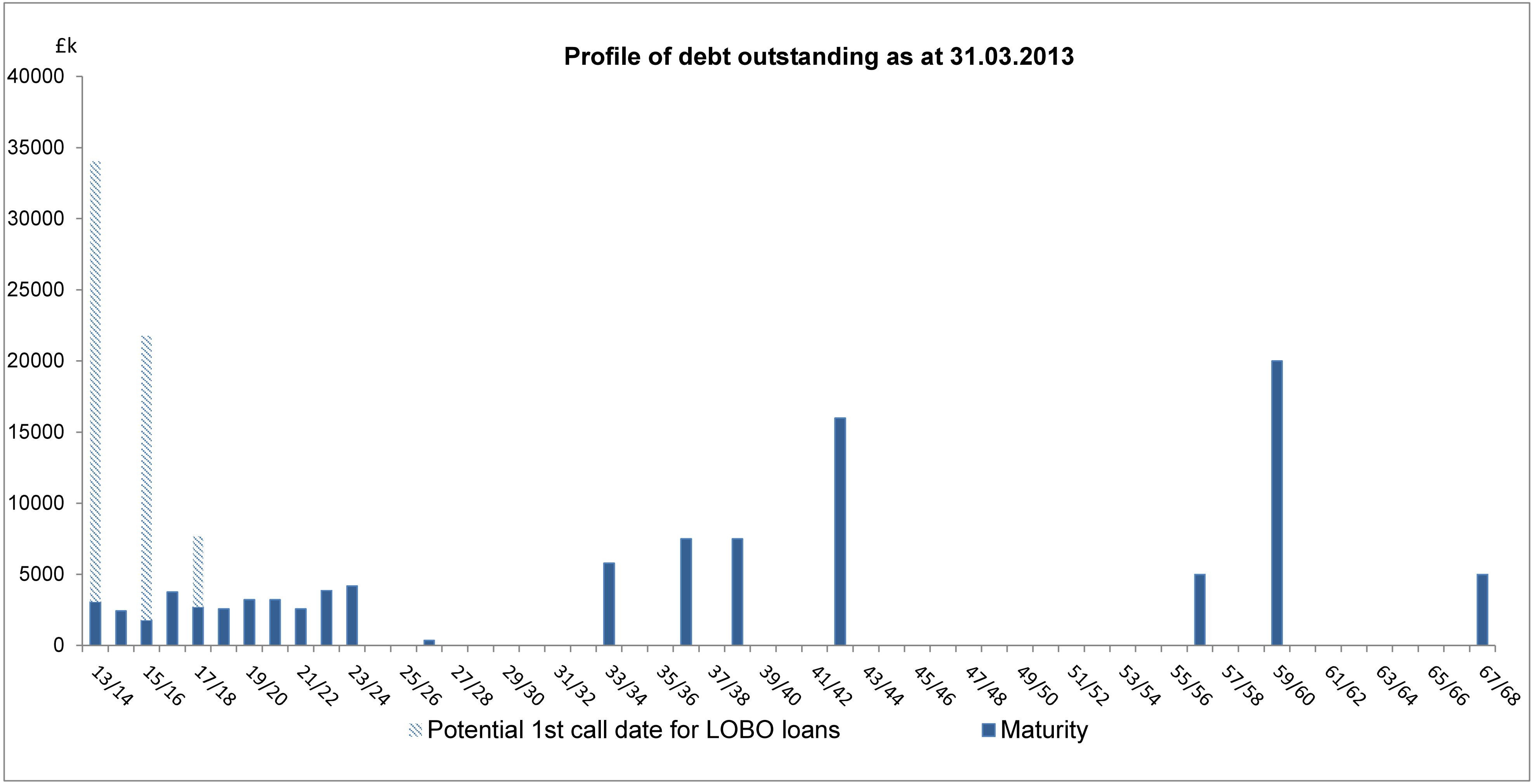
Long term rating	Average 1 yr default	Average 2 yr default	Average 3 yr default	Average 4 yr default	Average 5 yr default
AAA	**0.00%**	**0.02%**	**0.06%**	**0.09%**	**0.13%**
AA	**0.02%**	**0.04%**	**0.14%**	**0.28%**	**0.36%**
A	**0.09%**	**0.25%**	**0.43%**	**0.60%**	**0.79%**
BBB	**0.23%**	**0.65%**	**1.13%**	**1.70%**	**2.22%**
BB	**0.93%**	**2.47%**	**4.21%**	**5.81%**	**7.05%**
B	**3.31%**	**7.89%**	**12.14%**	**15.50%**	**17.73%**
C	**23.15%**	**32.88%**	**39.50%**	**42.58%**	**45.48%**

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 0.09% of the total investment (e.g. for a £1m investment the average loss would be £900). This is only an average as any specific counterparty loss is likely to be higher.

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

The availability of liquidity and the period of risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio (shorter WAL would generally represent less risk).

APPENDIX 4



Profile of debt outstanding as at 31.03.2013
£k
40000
35000
30000
25000
20000
15000
10000
5000
0
13/14
15/16
17/18
19/20
21/22
23/24
25/26
27/28
29/30
31/32
33/34
35/36
37/38
39/40
41/42
43/44
45/46
47/48
49/50
51/52
53/54
55/56
57/58
59/60
61/62
63/64
65/66
67/68
Potential 1st call date for LOBO loans
Maturity

APPENDIX 5

INVESTMENT & EXTERNAL DEBT PORTFOLIO AS AT 31.12.2012

		Principal £k	Average rate
External debt	PWLB Market	44,546 56,000	7.28% 3.65%
Total external debt		**100,546**	**5.26%**
Total Investments		**(73,349)**	**0.96%**
Net Position		**27,197**	

APPENDIX 6

GLOSSARY of ABBREVIATIONS

CDS	Credit Default Swaps – financial instrument for hedging against counterparty default
CLG	Communities & Local Government (Department of)
CIPFA	Chartered Institute of Public Finance & Accountancy
CFR	Capital Financing Requirement – this is a measure of the council's borrowing needs in order to finance its capital investment programme.
DMO	Debt Management Office – low credit risk UK Government investment Counterparty which offers low rates of return
LGC	Local Government Chronicle
LIBID	London Interbank BID interest rate – average rate of interest offered by the UK clearing banks
MRP	Minimum Revenue Provision – this is the amount required to pay off an element of the capital spend each year through a revenue charge
MTFP	Medium Term Financial Plan – 3 year financial plan
PFI	Private Finance Initiative – private sector source of funding
PWLB	Public Works Loan Board
TMP	Treasury Management Practices – details the methods in which the Council will achieve the treasury management policies and objectives and how it will manage and control them.
VRP	Voluntary Revenue Provision – identical to MRP but on a voluntary basis
WAL	Weighted Average Life – benchmark indicating average life of investments