



OVERVIEW AND SCRUTINY SELECT COMMITTEE

23 FEBRUARY 2012

APPENDICES

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Runnymede Borough Council

OVERVIEW AND SCRUTINY SELECT COMMITTEE

8 December 2011 at 7.40pm

Members of the Committee present: Councillors P B Tuley (Chairman), J M Edwards (Vice-Chairman), A Alderson, H A Butterfield, Mrs R M Denby, T Dicks, Mrs L M Gillham, and A P Tollett

Members of the Committee absent: Councillor C J Norman

398. FIRE PRECAUTIONS

The Chairman read out the Fire Precautions.

399. MINUTES

The Minutes of the meeting of the Committee held on 6 October 2011 were confirmed and signed as a correct record.

400. APOLOGIES FOR ABSENCE

Apologies for absence were received from Councillor C J Norman.

401. DECLARATIONS OF INTEREST

<u>Councillors</u>	<u>Item</u>	<u>Nature of Interest</u>
Councillor J M Edwards	Enforcement of Planning Control Progress Report	Prejudicial. Vice-Chairman of Planning Committee

402. ENFORCEMENT OF PLANNING CONTROL PROGRESS REPORT

The Committee noted the progress report on enforcement of planning control as at 3 November 2011, as submitted to the Planning Committee on 16 November 2011.

On particular cases, the following was noted:-

i) The Conifers, 111A Almnors Road, Lyne

A response was still awaited from the landowner on whether he was going to submit a planning application.

ii) Willow Farm, Chobham Road, Ottershaw

Following dismissal from the Court of Appeal, the appellant had 28 days to lodge an appeal at the Supreme Court.

iii) Double S, Stonehill Road, Ottershaw

File being reviewed following police investigations at the site. A Member suggested the name of the property had been changed to 'Forest Court Farm'. The possibility of a planning contravention at neighbouring property 'Merlewood' was also reported.

iv) Thorpe Waterski, Thorpe Road, Chertsey

Prosecution action being considered. Further action to be taken if contravention continued.

v) Padd Farm, Hurst Lane, Egham

Mr Beach pleaded guilty to all 13 counts on 16 November 2011. Sentencing would take place in January 2012.

vi) Woburn Park Farm, Woburn Hill, Addlestone

This large site had many contraventions and each contravention would need to be categorised prior to any enforcement action being taken. Members stressed that they felt it was fundamental that enforcement action was taken and hoped that due to the recent press coverage of 'Dale Farm' this would spur central Government into providing more assistance to local authorities.

vii) Arcadia, Hamm Court, Weybridge

Legal Officers were proceeding to pursue injunctive action.

viii) Glenfield, Hurst Lane, Egham

Prosecution proceedings took place on 8 December 2011. The Owner pleaded guilty on 2 counts. Fined £7,500 on each count. The Council was awarded its costs of £3,452.00.

ix) Southbeck, Ruxbury Road, Chertsey

This case had been adjourned until late December.

The Committee was pleased to note the enforcement list was considerably smaller.

The Committee stressed the importance of successful enforcement actions to be made public as soon as possible and the Council's Communication Officer would deal with this.

Chairman

(The meeting ended at 8.10 p.m.)

TREASURY MANAGEMENT STRATEGY, TREASURY MANAGEMENT INDICATORS AND ANNUAL INVESTMENT STRATEGY FOR 2011/12 AND 2012/13 (ICHF)

1.1 Purpose of Report

1.1 The purpose of this report is to recommend:

- **the formal adoption of the 2011 version of the CIPFA Treasury Management Code of Practice;**
- **revisions to the 2011/12 Treasury Management Strategy and Treasury Management Indicators in the light of the requirement to borrow for Housing purposes;**
- **a revised Treasury Management Policy Statement;**
- **a proposed Treasury Management Strategy , Treasury Management Indicators and Annual Investment Strategy for 2012/13.**

2. Background Information

- 2.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice Fully Revised Second Edition 2009* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. The Institute published a revised version of the CIPFA Code in November 2011 in the light of the additional financial freedoms available to local authorities in the Localism Act 2011.
- 2.2 In addition, the Department for Communities and Local Government (CLG) issued revised guidance on local authority investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.
- 2.3 The Corporate Head of Finance must report to this Committee on the proposed strategy for treasury management prior to the start of each financial year in order to fulfil the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.
- 2.4 On 1 February 2012 the DCLG published the final self-financing determinations for Council housing. The determination sets out the amount each local authority will either pay the Government or receive from the Government on 28 March 2012 in order to exit the current subsidy system, and the way in which the payments will be made. The debt settlement for Runnymede is £103.292 million. The maximum amount that the Council could borrow for HRA purposes is set marginally higher at £103.647 million.
- 2.5 On 19 September 2011, HM Treasury announced that the interest rate offered to local authorities by the PWLB would be reduced for borrowing for the purposes of making the settlement payment for the new local self-financed Council housing system on Monday 26th March 2012 only (for settlement on 28 March). The decision by HM Treasury to limit the offer to 26 March was to provide for fiscal certainty around a significant one-off transaction and, given ongoing uncertainty in the global financial markets, reduce the risks associated with local authorities holding large sums in advance of the transaction.

3. Economic Context

- 3.1 The UK economy is continuing its weak recovery from the 2008/09 recession, with GDP growth forecast to be around just 1.0% in 2011 and likely to remain sluggish throughout much of 2012. Government spending cuts, rising unemployment and uncertain export markets are conspiring to keep demand low, and a "double dip"

recession cannot be ruled out. Consumer price inflation, which peaked at 5.2% in September, is expected to fall sharply as one-off factors like 2010's VAT increase and fuel price rises fall out of the annual comparison.

- 3.2 In these circumstances, the Bank of England is unlikely to raise Bank Rate for several months, and additional quantitative easing is seen by many as being more likely than rate increases in the near future. However, once a more robust recovery appears to be taking root, the Bank is likely to prefer to gradually raise interest rates earlier, rather than waiting too late and needing to make a sharp correction.
- 3.3 The Eurozone sovereign debt crisis remains a major driver of market sentiment and with the UK seen a safe haven, gilt yields and hence PWLB rates have fallen markedly this year. Assuming that there is some resolution to the crisis, long-term rates are likely to climb back to more normal levels in 2012/13.
- 3.4 A second UK recession or a European sovereign default would see short and long term interest rates remaining lower for longer, while a faster economic recovery and a bold solution to the Eurozone crisis would likely see rates rise more quickly.

Interest Rate Forecasts

- 3.5 The interest rate forecast supplied by Sterling Consultancy Service, and forecasts of the Base Rate from the HM Treasury Survey of Forecasts are set out in the tables 1 and 2:

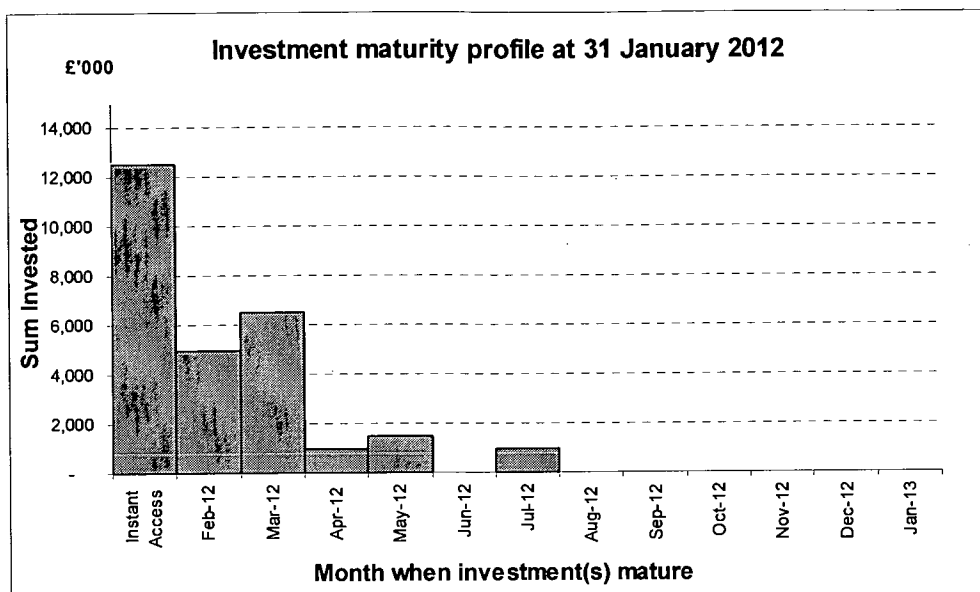
	Bank Rate	1 month LIBOR	3 month LIBOR	12 month LIBOR	25 year PWLB
Current	0.50	0.73	1.01	1.79	4.06
Q1 2012	0.50	0.70	1.00	1.75	4.20
Q2 2012	0.50	0.70	1.00	1.70	4.40
Q3 2012	0.50	0.75	1.00	1.80	4.50
Q4 2012	0.75	0.85	1.05	1.90	4.50
H1 2013	1.00	1.10	1.25	2.00	4.60
H2 2013	1.50	1.60	1.75	2.50	4.70
H1 2014	2.00	2.10	2.25	3.00	4.80
H2 2014	2.50	2.60	2.75	3.50	4.90

	Average annual Bank Rate %			
	2012	2013	2014	2015
Highest	1.1	2.6	3.0	3.7
Average	0.6	0.9	1.7	2.7
Lowest	0.5	0.5	0.9	1.4

4. Current and Expected Treasury Portfolios

Current Portfolio

- 4.1 The Council's treasury portfolio as at 31 January 2012 is set out on the next page.



- 4.2 The high proportion of cash balances held at short term rates result from the uncertainty as to whether the General Fund could lend to the Housing Revenue Account as part of its future debt strategy (it is now clear that this would not be advantageous), and the need to pay over large precept payments in February and March.

Expected Changes

- 4.3 The investment portfolio in 2012/13 is expected to range from £29m to £20m which includes the generation of capital receipts of £4.3m during this period. The large variance is due to the collection of local taxes in a 10-month cycle from April to January – whilst expenditure is from April to March – and also from the tendency for the Council's spending to be weighted towards the later parts of the financial year.
- 4.4 The taking on of the Housing debt will radically change the Council's cash flow forecasts in future years. The Council will become a net borrower of funds for the first time in almost 20 years.

Budget Implications

- 4.5 The budget for investment income in 2012/13 is £238,000 based on an average investment portfolio of £25million at an interest rate of 1%. The budget for debt interest paid in 2012/13 is £3.6 million, based on an average HRA debt portfolio of £103.7 million at an average interest rate of 3.5%. If actual levels of investments and borrowing and actual interest rates differ from those forecast, performance against budget will be correspondingly different. The split between the General Fund and HRA is as follows:

	General Fund	HRA	Total
Gross external investment income	205	33	238
Interest paid on deposits and other balances	(10)	-	(10)
Debt interest	-	(3,629)	(3,629)
Net Investment Income / (Debt interest)	195	(3,596)	(3,401)

- 4.6 The estimate is based on the level of revenue and capital reserves for 2012/13 that is consistent with the latest capital and revenue budgets contained in the Financial Forecast. The average investment return of 1.00% is consistent with the short-term interest rates set out in Table 1.

5. Treasury Management Code of Practice

5.1 The CIPFA Code was updated in November 2011 to reflect the changes being introduced under the Localism Act 2011. The main amendments to the Code relate to the potential use of derivatives and the reform of housing finance. The areas affecting the Council are:

- Clarification that the Treasury Management policy statement should include “the organisation’s high level policies for borrowing and investments”.
- Changes to the Treasury Management Practices (TMP) to reflect:
 - An update on counterparty risk to include counterparties to derivative arrangements
 - A new paragraph on interest rate risk to “ensure that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs and that the policy for the use of derivatives is clearly detailed in the annual strategy”
 - A requirement to seek and consider proper advice when using derivatives
- A New Treasury Management indicator – the upper limit on the proportion of net debt compared with gross debt – to highlight where an authority might be borrowing in advance of need.
- The need for a clear policy approved by full Council for splitting loans and sharing interest between the General Fund and HRA.

5.2 These requirements have all been reflected in the following paragraphs and relevant appendices (highlighted where appropriate).

6. Treasury Policy Statement

6.1 The new Code of Practice requires some amendments to the Council’s Treasury Management Policy Statement. A revised Policy Statement is set out in Appendix ‘1’ and Members are asked to approve this for 2012/13.

7. Annual Investment Strategy 2012/13

7.1 Local authorities must draw up an “Annual Investment Strategy” for the following financial year. The strategy is to be approved by full Council. This strategy may be revised at any time, but full Council must approve the revisions. Both the CIPFA Code and the CLG Guidance require to Council to invest its funds prudently, and to have regard to the **security** and **liquidity** of its investments before seeking the highest rate of return, or **yield**. This approach is inherent in the Council’s treasury management strategy.

7.2 The Committee approved its Annual Investment Strategy for 2010/11 in February 2011. The proposed Annual Investment Strategy for 2012/13 is set out in Appendix ‘2’. The parts of the Strategy that have changed are highlighted. The CLG Guidance requires local authorities to cover a number of issues in their Annual Investment Strategy, and these are set out in the following paragraphs.

Non-specified investments

7.3 The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - o the UK Government,
 - o a UK local authority, parish council or community council, or
 - o a body or investment scheme of "high credit quality".

7.4 Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement. The total limit on long-term investments, and the total limit on non-specified investments is £5 million.

Building Societies

7.5 UK building societies without credit ratings will be considered to be of "high credit quality", but subject to a lower cash limit and shorter time limit than rated societies. The Council takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors. Investments in lower rated and unrated building societies will be reviewed if the insolvency regime is amended in future. However, no investments will be made with building societies that hold a long-term credit rating lower than BBB or equivalent, due to the increased likelihood of default implied by this rating.

Money Market Funds

7.6 Money market funds are pooled investment vehicles consisting of instruments similar to those used by the Council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Funds that offer same-day liquidity and a constant net asset value will be used as an alternative to instant access call accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Foreign Countries And Counterparties

7.7 In March 2010, the Council agreed that it was prudent to recommence lending to foreign banks, but subject to higher credit criteria than UK banks and for short-term duration only. This change had been made with a view, in particular, of making investments in the deposit accounts of the UK based banks that formed part of the Santander Group. However, since then the risk in investing in foreign banks has seemed to have increased, mainly reflecting concern over sovereign ratings.

7.8 Given that security of funds is the main objective of the Council's treasury strategy, no investments have been made with foreign banks. However, for the sake of completeness, the Annual Investment Strategy allows investments with foreign banks, but with much higher credit limits.

Risk assessment and credit ratings

7.9 Runnymede Borough Council is treated as a "professional investor" and does not enjoy the protections offered to private investors. However, being a professional investor does not bestow any powers of foresight or special insight into the credit worthiness of banks and other financial institutions. The security of investments has always been the main emphasis of the Council's treasury strategy.

- 7.10 The Council uses long-term credit ratings from the three main rating agencies (Fitch Ratings Ltd, Moody's Investors Service Inc and Standard & Poor's Financial Services LLC) to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality.
- 7.11 Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The Council's credit rating criteria are set to ensure that it is unlikely that the Council will hold speculative grade investments, despite the possibility of repeated downgrades.
- 7.12 Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
- 7.13 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the above criteria, then no further investments will be made in that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks (see Definitions on the last page of the Annual Investment Strategy).

Other information On The Security Of Investments

- 7.14 The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the above criteria.
- 7.15 When deteriorating financial market conditions affect the creditworthiness of all organisations, as in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions.
- 7.16 If these restrictions mean that insufficient commercial organisations of "high credit quality" are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Planned investment strategy for 2012/13

- 7.17 The Council's cash flow forecast is used to divide surplus funds into three categories:
- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
 - Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.

- Long-term – cash not required to meet cash flows, and used primarily to generate investment income.
- 7.18 Short-term funds are required to meet cash obligations occurring in the next month, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it should not be ignored. Instant access AAA-rated money market funds and bank deposit accounts will be the main methods used to manage short-term cash.
- 7.19 Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. A wide spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks. Deposits with lower credit quality names will be made for shorter periods only, while deposits with higher quality names can be made for longer durations.
- 7.20 For long-term funds the position is a little trickier. The reduction in overall revenue and capital balances is an important constraint on long-term lending. Furthermore, the uncertainties over the timing of future capital receipts, and the possibilities of investing in rather than selling development sites, means that the sums that can be prudently set aside for long-term investment are limited. Nevertheless, there may still be good opportunities to lock into good long-term interest rates, probably for shorter terms than 5 years, with good quality institutions during 2012/13 should market conditions become favourable. In this case, investment income would increase accordingly. Making a modest further long-term investment would also provide a balance to the investment portfolio and mitigate the interest rate risk inherent in keeping all investments for short-terms.
- 7.21 Taking these factors into account, it is proposed to maintain the limit on long-term investments at no more than £3million during 2012/13. This does not mean that this sum has to be invested in long-term investments. The decision on the appropriate term of an investment will continue to be a balanced judgement of all investment risks.

Borrowing Strategy

- 7.22 The current Treasury Management Strategy deals principally with the management of the Council's investments and day-to-day cash management. Therefore, the strategy needs to be amended to allow for the borrowing that will be required as part of the housing reform and also to cater for the investment of any borrowing that is taken out prior to the settlement date.
- 7.23 The settlement date of 28 March 2012 was determined by HM Treasury. Because this date falls in 2011/12, the Council's treasury strategy and certain prudential indicators for 2011/12 will have to be formally changed to allow for taking on the borrowing on this date in order to comply with statutory requirements.
- 7.24. The Council does not currently have a strategy for long term borrowing. Officers are currently considering a loan structure for the housing debt settlement in consultation with the Council's treasury management advisors, Sterling Consultancy Services. At this stage the working assumption is that the maturity profile of the borrowing will be broadly based on the cash flow information set out in the Housing Revenue Account Business Plan.

- 7.25. The following additions to the Councils treasury management strategy are required in order to accommodate the taking on of the housing debt:

POLICY ON BORROWING

Sources of borrowing

The approved sources of long-term and short-term borrowing will be:

- *Public Works Loan Board (PWLB)*
- *any institution approved for investments*
- *any other bank or building society approved by the Financial Services Authority*
- *Capital market bond investors*
- *Special purpose companies created to enable joint local authority bond issues.*

Debt instruments

Borrowing will be arranged by one of the following debt instruments:

- *fixed term loans at fixed or variable rates of interest, subject to the limits in the treasury management indicator below (see section 8)*
- *lender's option borrower's option (LOBO) loans, subject to a maximum of £10 million*
- *bonds*

- 7.26 The advantageous terms offered by the PWLB for local authorities taking on debt on 28 March means that it is highly likely that the Council will use the PWLB to finance the debt settlement. However, the other sources of finance may provide a beneficial option and they are therefore included in the proposed policy.
- 7.27 There are currently no plans to borrow for purposes other than the taking on of the housing debt settlement.

Investment of money borrowed in advance of need

- 7.28 This has not previously been a major feature of treasury policy as the Council has not needed to borrow. However, although this seems unlikely, it could be beneficial to borrow a proportion of debt in advance of any future settlement date where there are circumstances that strongly indicate that there would be a financial advantage.
- 7.29 Therefore, it is proposed to replace the existing wording in the Annual Investment Strategy for borrowing in advance of need to the following:

POLICY ON BORROWING IN ADVANCE OF NEED

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated.

In determining whether borrowing will be undertaken in advance of need the council will:

- a) *Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.*
- b) *Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.*

- c) *Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.*
- d) *Consider the merits and demerits of alternative forms of funding.*

Policy on Use of Financial Derivatives

- 7.30 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).
- 7.31 The Localism Act 2011 includes a general power of competence that removes the uncertain legal position over local authorities' use of stand alone financial derivatives (i.e. those that are not embedded into a loan or investment). The latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.
- 7.32 The Council will only use stand alone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council to which the Council is exposed. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Derivative Counterparties

- 7.33 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Policy On Charging Interest To The Housing Revenue Account

- 7.34 Following the reform of housing finance, the Council is free to adopt its own policy on sharing interest costs and income between the General Fund and Housing Revenue Account (HRA). The CIPFA Code recommends that authorities state their policy on this matter each year in their treasury management strategy.
- 7.35 In the future, new long-term loans borrowed will be assigned in their entirety to either the General Fund or the HRA pool. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be divided accordingly.
- 7.36 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the monthly net average rate earned by the Council on its portfolios of treasury investments and short-term borrowing.

8. Treasury Management Indicators

- 8.1 The CIPFA Code on Treasury Management requires the Council to approve the following indicators.

Gross and Net Debt

- 8.2 This is a new indicator introduced by the 2011 Code to highlight where an authority may be borrowing money in advance of spending need.

	2011/12	2012/13	2013/14	2014/15
Upper limit on the proportion of net debt compared to gross debt	100%	100%	100%	100%

- 8.3 This is a rogue indicator. Borrowing without spending increases gross debt but not net debt. The ratio of net to gross debt will therefore reduce (assuming net debt is positive), making an upper limit useless. On the other hand, borrowing and spending the cash (the outcome CIPFA is encouraging) will increase both net debt and the net to gross ratio, and may put some pressure on the limit set. In the absence of any clarification or revision from CIPFA an upper limit of 100% has been set, the maximum possible.

Interest rate Exposures

- 8.4 This indicator is set to control the Council's net exposure (taking borrowings and investments together) to interest rate risk. The upper limits proposed on fixed and variable rate interest rate exposures, expressed as the principal sums outstanding are:

	2011/12	2012/13	2013/14	2014/15
Upper limit on fixed interest rate exposures	£105m	£105m	£105m	£105m
Upper limit on variable interest rate exposures	£unlimited	£unlimited	£unlimited	£unlimited

- 8.5 Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate. If it is not clear whether an instrument should be treated as fixed or variable rate, then it is treated as variable rate.
- 8.6 The proposed variable rate upper limit of unlimited is required to cater for the possibility that all investments may be variable rate investments at any point in time. In such a case, the Council would be absolutely exposed to changes in short-term interest rates. The use of longer-term investments mitigates this risk by having at least a proportion of investments at a fixed rate. However, longer-term investments carry additional risk (especially credit and liquidity risk) compared to short-term investments.

Maturity Structure Of Borrowing

- 8.7 This indicator is set to control the Council's exposure to refinancing risk. The proposed upper and lower limits on the maturity structure of fixed rate borrowing are based on the current proposals for taking on the housing debt settlement. These are:

Table 6 - Proposed upper and lower limits on the maturity structure of fixed rate borrowing

	Upper	Lower
Under 12 months	10%	0%
12 months and within 24 months	10%	0%
24 months and within five years	25%	5%
Five years and within 10 years	50%	15%
10 years and above	80%	40%

8.8 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than 364 days

8.9 The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The proposed limits on the total principal sum invested to final maturities beyond the period end are:

Table 7 - Principal sums invested for periods longer than 364 days				
	2011/12	2012/13	2013/14	2014/15
Limit on principal invested beyond year end	£3m	£5m	£5m	£1m

8.10 The limit for 2011/12 equals the long-term investment limit under non-specified investments. In 2012/13 onwards the HRA could well generate large surpluses as it holds onto funds pending any agreed future redevelopment proposals. The limit of £5m represents potential investments maturing beyond 2012/13 and matches the £5m limit of cash identified as available for long-term investment set out in the Annual Investment Strategy. The limit for investments maturing beyond 2014/15 (i.e. 3 year or longer terms) is £1m.

Borrowing limits

8.11 The Council must also approve the following treasury indicators for borrowing:

- Authorised limit for external debt
- Operational boundary for external debt
- Actual external debt

8.12 These are set out in the Prudential Indicators report being presented to the Corporate Management Committee on 1 March.

9. Governance issues – amendment of treasury policy documents

9.1 The Treasury Management Practices and Schedules will be updated in accordance with this report and the decision of the Council. Minor amendments to reflect changes in the duties of staff within the Finance Department will also be made.

10. Legal Implications

10.1 The powers for a local authority to borrow and invest are governed by the Local Government Act 2003 and associated Regulations. A local authority may borrow or invest for any purpose relevant to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs. The Regulations also specify that authorities should have regard to the CIPFA Treasury Management Code and the Department for Communities and Local Government (DCLG) Investments Guidance when carrying out their treasury management functions.

11. Summary and Conclusion

- 11.1 The Annual Investment Strategy provides that management of counterparty risk is the treasury management priority.
- 11.2 The Council is becoming more exposed to short-term interest rates as long-term investments mature. Since 2008, the re-investment of long-term maturities has been for relatively shorter periods (up to one year), mainly because of the uncertainties over the credit worthiness of banks and building societies generally. Also, current longer-term interest rates are not particularly attractive, and interest rate forecasts indicate that higher returns may be available in the future. However, this means that investment income is reducing sharply because higher rate long-term maturities are being replaced with significantly lower rate short-term investments.
- 11.3 The estimate for 2012/13 is based on achieving an overall return on investments of 1.0%. If prevailing interest rates or the cash flow forecast significantly changes it will be necessary to revise the investment income budget and report to this Committee with proposals for further action.

OFFICERS' RECOMMENDATION that -

- i) the Council adopts the 2011 version of the CIPFA Treasury Management Code of Practice;**
- ii) the 2011/12 Treasury Management Strategy be revised to include the borrowing strategy as set out in paragraphs 7.22 to 7.29 of this report;**
- iii) the Treasury Management Strategy and treasury management indicators, as set out in this report, be approved;**
- iv) the Treasury Management Policy Statement, as set out in Appendix '1', be approved;**
- v) the Annual Investment Strategy for 2012/13, as set out in Appendix '2', be approved; and**
- vi) Officers be authorised to make the necessary changes to Treasury Management Practices and associated documents to reflect the changes set out in this report and Appendices.**

(TO RECOMMEND)

Background Papers

- 1. Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes – 2011 Edition – CIPFA
- 2. Treasury Management in the Public Services – Guidance Notes for Local Authorities including Police Authorities and Fire Authorities – CIPFA
- 3. Guidance On Local Government Investments – DCLG, 2010
- 4. The Housing Revenue Account Self-financing Determinations - DCLG, 1 February 2012

RUNNYMEDE BOROUGH COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT

Introduction

This Statement sets out the Council's treasury management policy. It meets the recommendations set out in the *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (2011 Edition) issued by the Chartered Institute of Public Finance and Accountancy.

Definition of Treasury Management Activities

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

Statement of Overall Policy

Risk management

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 organisation, and any financial instruments entered into to manage these risks.

Value for money

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.

Borrowing policy

The Council greatly values revenue budget stability and will therefore borrow the majority of its long-term funding needs at long-term fixed rates of interest. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.

The Council will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003*, and will have regard to the *CIPFA Prudential Code for Capital Finance in Local Authorities* when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy

The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.

The Council will have regard to the *Communities and Local Government Guidance on Local Government Investments* and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.

ANNUAL INVESTMENT STRATEGY FOR THE 2012/13 FINANCIAL YEAR

Introduction

1. The Council approved the Annual Investment Strategy for 2012/13 on 8 March 2012.
2. This strategy applies to both in-house and externally managed funds. External managers must confirm the acceptability of a counterparty before an investment is made.

General Provisions

3. All investments must be made in sterling.

Credit risk assessment

4. Credit ratings are an important, but not the only, means of assessing creditworthiness. Full regard will be given to other available information on the credit quality of counterparties. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the criteria set out in this Strategy. The Corporate Head of Finance has access to treasury consultants, and has a copy of the Financial Times delivered daily, to help in providing this sort of information in an appropriate way. Therefore, in addition to credit ratings, the Corporate Head of Finance will consider the following factors when making investments and reviewing the credit quality of investments currently held:

- a. **Quality financial press** – watch for any market rumours
- b. **Credit default swaps** - CDS are a financial instrument for swapping the risk of debt default. The buyer of a credit default swap pays a premium for effectively insuring against a debt default. He receives a lump sum payment if the debt instrument is defaulted. The seller of a credit default swap receives monthly payments from the buyer. If the debt instrument defaults they have to pay the agreed amount to the buyer of the credit default swap. Although absolute prices can be unreliable, trends in CDS spreads do give an indicator of relative confidence about credit risk.
- c. **Share price**– changes in share prices are an indicator of market confidence
- d. **Annual reports**
- e. **Statements to the market**
- f. **Information on Government support for banks**– if a Government is likely to step in to support a bank then this reduces the risk of default
- g. **Credit ratings of Government support**– the weight placed on potential support from a Government that does not itself have a high credit rating
- h. **The rates being paid** - If they are out of line with the market, there is a reason and could indicate that the investment is likely to carry a high risk
- i. **What other banks are saying** - Rumours spread quickly in markets
- j. **Information provided by management advisors**– this may include some of the information detailed above.
- k. **Market price (and movement in the market price) of existing debt securities issued by counterparties** – if other lenders are getting worried about a particular counterparty they will be selling the counterparty's debt securities and, by doing so, pushing down the price of those securities in the market.

Credit ratings used

5. Our treasury management consultants (currently Sterling Consultancy Services) provide us with routine lists of credit ratings at least every month, and any urgent changes on a daily basis. The lists of investment counterparties are changed immediately new credit ratings are received. The tables on the next page compare the long-term and short-term ratings used by the various credit rating agencies to enable fund managers to use ratings from different rating agencies:

Table A: Comparison of long-term credit ratings		
Moody's	S&P	Fitch
Investment grade		
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Speculative grade		
Ba1	BB+	BB+
Ba2	BB	BB
Ba3 and below	BB- and below	BB- and below

Comparison of Short-Term Ratings		
Moody's	S&P	Fitch
Investment grade		
Prime-1 "P1"	A-1+	F1+
Prime-1 "P1"	A-1	F1
Prime-2 "P2"	A-2	F2
Prime-3 "P3"	A-3	F3
Speculative grade		
Not Prime	B	B
	C	C
	D	D

6. All decisions on placing new investments are to be made on the basis of the lowest ratings issued by all three main agencies, Fitch, Moody's and Standard and Poors.
7. Long-term credit ratings will be used in setting investment limits with counterparties, including setting limits for investments for a term of less than 12 months. This is because long-term ratings provide a finer grading scale compared to short-term ratings.
8. Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the above criteria, then no further investments will be made in that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks.

Sector limits

9. As far as reasonably possible, no more than 75% of total investments made are to be lent to building societies at any one time. Where possible, some investments outside of the banking sector will form part of the portfolio held. These sector limits are not to be regarded as absolute limits and it is recognised that, from time to time, short-term cash requirements may mean that the limit is temporarily exceeded.

Counter party maximum limit

10. Investments made must avoid an over concentration with one or two counter parties. A set of maximum counterparty limits is therefore appropriate. The maximum limit of investment with any one authorised institution is £2.5m, although lower limits apply to certain categories of counterparties as set out in this Strategy.
11. Managers of externally managed funds are required to confirm that a counterparty name is acceptable before making an investment.

12. The limit for money market funds where deposits are callable at immediate notice is £3.0m. This is higher than the limit for investment with any one authorised institution because of the protection offered by the diversity and high credit rating of such funds.

13. The limit for longer duration money market funds is £2.0m.

Investments in any parent and its wholly owned subsidiaries

14. Investments in any parent and its wholly owned subsidiaries are to be aggregated for the purpose of calculating the limit of investment to that parent or its subsidiaries.

Counterparty list

15. The Corporate Head of Finance will maintain a counterparty list in compliance with these criteria.

Policy for specified investments and credit criteria used

16. The DCLG statutory guidance defines specified investments as those expected to offer relatively high security and liquidity, and can be entered into with the minimum of formalities. The DCLG Guidance defines specified investments as those:

- denominated in pounds sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - a. the UK Government,
 - b. a UK local authority, parish council or community council, or
 - c. a body or investment scheme of high credit quality

17. Non-specified investments are those that do not meet these criteria.

18. Table B sets out the counterparties that can be used and the limits that apply:

Table B: Specified investments - Limits			
	Credit rating (Fitch)	Maximum limits	
		Term up to	Sum
UK Banks and their subsidiaries (see paragraph 20)	A+	364 days	£2.5m
UK Banks and their subsidiaries (see paragraph 20)	A	6 months and 7 days	£2.0m
UK Banks and their subsidiaries (see paragraph 20)	A-	3 months and 7 days	£2.0m
Local, Police, Fire, Civil Defence & Transport Authorities	N/A	364 days	£2m
Government bonds (gilts) and treasury bills	N/A	364 days	No limit
Debt Management Agency Deposit Facility (DMADF)	N/A	364 days	No limit
Multinational Development Banks (see paragraph 22)	AAA rated	364 days	£1m
Money Market Funds: Liquid funds (see paragraph 23)	AAA	On call	£3m
Money Market Funds: Longer duration funds (para. 24)	AAA	183 days	£2m
Foreign banks domiciled in one country that holds a AAA or AA+ sovereign credit rating	AA-	On call only	£1m

Building Societies			
	Credit rating (Fitch)	Maximum limits	
		Term up to	Sum
UK Building Societies (credit rating of A- or better)	A-	364 days	£2.5m
UK Building Societies (credit rating of BBB+)	BBB+	6 months and 7 days	£1.5m
UK Building Societies (credit rating of BBB)	BBB	6 months and 7 days	£1.0m
UK Building Societies with assets exceeding £500m without a credit rating	N/A	4 months and 7 days	£1.0m

19. No investments will be made with building societies that hold a long term credit rating below BBB, or whose credit rating is on review for possible downgrade.
20. Investment in any bank and its wholly owned subsidiaries are to be aggregated for the purpose of calculating the limit of investment to that bank or its subsidiaries.
21. If credit ratings are downgraded below criteria, the counterparty will be suspended from counterparty list and no further investments will be made with it.

22. Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and World Bank) or other supranational organisations (e.g. the European Union).

Money market funds

23. Accounts may be opened in money market funds that have a credit rating of AAA subject to the advice of our treasury management consultants as to confirmation of the credit worthiness and liquidity of the fund, the performance of the fund, and other matters as appropriate. The maximum investment in any one short-term fund that provides immediate access to funds is £3m.
24. The limit for investments made in longer duration money market funds – these can be realised after a period of notice or be for fixed terms up to one year - is £2m.
25. Our practice is to have more than one money market account available to ensure that there is sufficient flexibility to move funds if circumstances require, and to achieve a wide spread of investments.

Building Societies

26. The Council takes comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors. Investments in lower rated and unrated building societies will be reviewed if the insolvency regime is amended.

Derivative counterparties

27. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Forward deals up to one year

28. Forward deals may be entered into with banks and building societies that meet the appropriate credit rating criteria for specified investments where the total period of the investment (i.e. negotiated deal period plus period of deposit) is less than one year.

Policy for non-specified investments and credit criteria used

29. Non-specified investments are those that do not meet the criteria for specified investments.
30. The advice of our treasury management consultants will be sought prior to making any long-term investment as to appropriateness of the investment.
31. Non-specified investments may be made subject to the limits set out in Table C:

Table C: Non-specified Investments Limits					
	Minimum credit ratings (Fitch)			Maximum limits	
	Long-term	Individual	Support	Term up to	Sum
UK Banks	See Table D				
Subsidiaries of UK Banks	See Table D				
Local authorities	N/A	N/A	N/A	5 years	£1m
UK Building Societies	See Table E				
UK Government bonds (gilts)	N/A	N/A	N/A	5 years (to maturity of gilt from date of purchase)	£3m
Multinational Development Banks	AAA rated			5 years	£1m
Corporate Bonds	See Table D				

32. The maximum duration of a long-term investment with a UK bank will depend upon its lowest published long-term credit rating based on the criteria set out in Table D:

Table D: Credit rating criteria for determining the maximum duration of an investments with a UK Bank		
Long-term credit rating	Time limit	Maximum sum
AAA	5 years	£1m
AA+	4 years	£1m
AA	3 years	£1m
AA-	2 years	£1m

33. The maximum duration of a long-term investment with a UK building society will depend upon its lowest published long-term credit rating based on the criteria set out in Table E:

Table E: Credit rating criteria for determining the maximum duration of an investments with a UK Building Society		
Long-term credit rating	Time limit	Maximum sum
AAA	5 years	£1m
AA+	4 years	£1m
AA	3 years	£1m
A	2 years	£1m

34. The limit on the amount that may be held in non-specified investments, these being long-term investments only, at any time in the financial year is £5 million (excluding any accrued interest).

Policy for liquidity of investments

35. The proportion of the in-house portfolio that may be held in short-term and long-term investments will vary at any one time dependant on the cash flow position of the Council. The following table sets out the maximum, minimum and expected range of investments held at various times of the year:
- 36.

Table F: Proportions of the in-house managed investments held in short-term and long-term investment instruments				
Time of year	Long-term investments		Short-term investments	
	Maximum	Minimum	Maximum	Minimum
	%	%	%	%
Start of year	100	0	100	75
June	50	0	100	50
September	50	0	100	50
December	50	0	100	50
End of year	100	0	100	0

37. The proportions in the table reflect that at the end of the year cash inflows are low because tax receipts are received in 10 instalments from April to January. Therefore, long-term investments may represent the entire investment portfolio for a short time. Normally it is expected that long-term investments will not exceed 50% of total investments.
38. The amount of investments (both managed in house and externally) that may be held in long-term investments will be, measured on a rolling basis, at any point in time:
- No more than £1 million of outstanding investments are to be over 3 years until maturity, and
 - No more than £3 million of outstanding investments are to be over 1 year until maturity.
39. The maximum term of any one investment is 5 years.

Other issues

Investments defined as capital expenditure

40. The acquisition of share capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'.
41. A loan or grant to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure. It is therefore important that it is clearly identified when the loan has made for policy reasons (e.g. to the registered social landlord for the construction/improvement of dwellings) or if it is an investment for treasury management purposes. The framework for 'specified' and 'non-specified' investments will govern investments that are for treasury management purposes.

Forward deals for more than one year

42. Forward deals with banks and building societies that meet the appropriate credit rating criteria for non-specified investments where the total period of the investment (i.e. negotiated deal period plus period of deposit) is greater than one year may be made subject to the limits set out in the "Policy for liquidity of investments" section.

Investment of money borrowed in advance of need

43. The council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated.

In determining whether borrowing will be undertaken in advance of need the council will:

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.

- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.

- Consider the merits and demerits of alternative forms of funding.

44. The total amount borrowed will not exceed the authorised borrowing limit of £107 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

Review of investment strategy

45. The Council 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 Treasury Management Practices.
46. This Strategy may be amended on these occasions, or other circumstances as may be appropriate. Any revised Strategy will be approved by the full Council.
47. This Strategy is deemed to include sufficient flexibilities and delegations to avoid the need for a formal submission to the full Council being triggered by purely technical circumstances.

Investment consultants

48. The Council contracts with Sterling Consultancy Services to provide advice and information relating to its investment and borrowing activities. However, responsibility for final decision making remains with the Council and its Officers. The services received include:
 - advice and guidance on relevant policies, strategies and reports,
 - advice on investment decisions,
 - notification of credit ratings and changes,
 - other information on credit quality,
 - advice on debt management decisions,
 - accounting advice,
 - reports on treasury performance,
 - forecasts of interest rates, and
 - training courses.

49. The quality of this service is controlled by the Corporate Head of Finance assessing the quality of advice offered and other services provided by Sterling Consultancy Services. In particular, the Corporate Head of Finance holds regular (normally 3 to 4 times a year) meetings with Sterling Consultancy Services where, in addition to discussing treasury strategy, the performance of the consultants is reviewed.
50. In addition, a market testing exercise is conducted every three years when other treasury consultants are invited to submit proposals to carry out the service. These proposals are analysed for quality and price in accordance with the procedures set out in the rules on the use of professional and consultancy services published in the Council's Constitution (as part of Standing Orders for Contracts).

Investment training

51. The needs of the Council's treasury management staff for training in investment management are assessed every year as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Relevant training courses, seminars and conferences are provided by Sterling Consultancy Services.

Publication of this Strategy

52. This Strategy is published in the Minutes of the Council and is available on the Council's website under 'Finance' and then 'Treasury Policies'. A copy of this Strategy will be made available to the public free of charge in print if requested.

Definitions

(Negative) Rating Watch – Fitch Ratings

Rating Watches indicate that there is a heightened probability of a rating change and the likely direction of such a change. These are designated as "Positive", indicating a potential upgrade, "Negative", for a potential downgrade, or "Evolving", if ratings may be raised, lowered or affirmed. However, ratings that are not on Rating Watch can be raised or lowered without being placed on Rating Watch first, if circumstances warrant such an action.

Review for possible downgrade - Moody's (Standard & Poor's is very similar)

Moody's uses the 'Watchlist' to indicate that a rating is under review for possible change in the short-term. A rating can be placed on review for possible upgrade (UPG), on review for possible downgrade (DNG), or more rarely with direction uncertain (UNC). A credit is removed from the Watchlist when the rating is upgraded, downgraded or confirmed

(Negative) Rating Outlook – Fitch Ratings (Moody's and Standard & Poor's are similar)

Rating Outlooks indicate the direction a rating is likely to move over a one- to two-year period. They reflect financial or other trends that have not yet reached the level that would trigger a rating action, but which may do so if such trends continue. The majority of Outlooks are generally Stable, which is consistent with the historical migration experience of ratings over a one- to two-year period. Positive or Negative rating Outlooks do not imply that a rating change is inevitable and, similarly, ratings with Stable Outlooks can be raised or lowered without a prior revision to the Outlook, if circumstances warrant such an action. Occasionally, where the fundamental trend has strong, conflicting elements of both positive and negative, the Rating Outlook may be described as Evolving.