

# Treasury management strategy statement and prudential indicators 2013/18

## Key issues and decisions

To set the Council's prudential indicators for 2013/14 to 2017/18, approve the minimum revenue provision (MRP) policy for 2013/14 and agree the treasury management strategy for 2013/14.

## Introduction

- B.1. Each year the County Council is required to update and approve its policy framework and ongoing strategy for treasury management in order to reflect changed market conditions, changes in regulation, and other changes in the Council's financial position. It is a statutory requirement that the policy framework and strategy are approved by the Full County Council before the beginning of the financial year. This annex sets out updated versions of the Council's treasury management policy statement and Appendix B.8 sets out the Council's treasury management strategy.
- B.2. Since 2009/10 the Council's treasury management strategy has followed an extremely cautious approach as a direct result of the Council's experience with Icelandic banks. Moving forward into 2013/14, several changes are proposed to the treasury management strategy reflecting the current economic climate and Council's risk appetite. The changes are detailed below but can be summarised as follows.
- Maximise the benefit of current unprecedented low interest rates and our high cash balances by reducing the minimum cash balance from £135m to £49m. (paragraph B.26)
  - Slightly expand the current counterparty list of institutions with which the Council will place short term investments to reflect market opinion as well as formal rating criteria. This means that Barclays Bank, whose rating change in 2012 reduced and effectively removed them from the eligible list is now eligible again. (paragraph B.45 to B.48 and Appendix B5)
  - Increase the monetary limit for the two instant access accounts from £40m to £60m since both have nationalised status and therefore minimum risk. (paragraph B.43)
  - Adjust the Council's minimum revenue provision policy to match the useful lives of the assets created or acquired. (paragraph B.77 and Appendix B7)

## Background

- B.3. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk

counterparties or instruments commensurate with the Council’s low risk appetite, providing adequate liquidity initially before considering investment return.

B.4. The second main function of the treasury management service is the funding of the Council’s capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

B.5. CIPFA defines treasury management as:

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

### **Reporting requirements**

B.6. The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actual:

- treasury management policy, strategy statement and prudential indicators report
  - the capital plans (including prudential indicators);
  - a minimum revenue provision (MRP) policy, stating how residual capital expenditure is charged to revenue over time;
  - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
  - an investment strategy (the parameters on how investments are to be managed).
- mid year treasury management update reports
  - update of progress on treasury and capital position
  - amendment of prudential indicators where necessary
  - view on whether the treasury strategy is on target or whether any policies require revision.
- an annual treasury management outturn report
  - details of the actual prudential and treasury indicators and actual treasury operations compared with the estimates within the strategy.

### **Treasury management strategy for 2013/14**

B.7. The strategy for 2013/14 covers two main areas:

- capital issues:
  - the capital plans and the prudential indicators;
  - the minimum revenue provision (MRP) strategy.
- treasury management issues:
  - the current treasury position;
  - treasury indicators which limit the treasury risk and activities of the Council;
  - prospects for interest rates;
  - the borrowing strategy;

- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

B.8. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Communities and Local Government (CLG) MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

#### **Treasury management consultant**

B.9. The Council uses Sector as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

B.10. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

#### **Training**

B.11. Officers and members involved in the governance of the Council's treasury management function are required to participate in training. Officers are also expected to keep up to date with matters of relevance to the operation of the Council's treasury function. Officers continue to keep abreast of developments via the CIPFA Treasury Management Forum as well as through local authority networks. Sector provides daily, weekly and quarterly newsletters and update meetings are held with Sector twice a year.

B.12. The CIPFA Treasury Management Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

#### **Capital prudential indicators 2013/14 to 2017/18**

B.13. The Prudential Code plays a key role in capital finance in local authorities. The Prudential Code was developed as a professional code of practice to support local authorities in their decision making processes for capital expenditure and its financing. Local authorities are required by statutory regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

B.14. The Council's capital expenditure plans are the key driver of treasury management activity. The framework of prudential indicators aims to ensure that an authority's capital investment plans are affordable, prudent and sustainable. As part of the

strategic planning process, authorities are required, on a rolling basis, to calculate a range of indicators for the forthcoming budget year and two subsequent years. Authorities are also required to monitor performance against indicators within the year as well as preparing indicators based on the statement of accounts at each year end. Indicators relate to capital expenditure, external debt and treasury management.

- B.15. Members are asked to approve the prudential indicators set out in Appendix B1. Details and explanations of all prudential terms are set out in Appendix B2.

### **Borrowing**

- B.16. The capital expenditure plans set out in Appendix A4 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury and prudential indicators, the current and projected debt positions and the annual investment strategy.
- B.17. Table B1 summarises the Council's treasury portfolio position at 31 March 2012, with forward projections. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the capital financing requirement or CFR), highlighting any over or under borrowing. The authority has adopted a treasury management strategy that favours fixed rate borrowing to provide certainty over borrowing costs and rates of interest.

**Table B1: Current portfolio position**

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
<b>External debt</b>	<b>Actual</b>	<b>Projected</b>	←	-----	Estimated	-----	→
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Debt at 1 April	320	315	320	328	362	385	383
Expected change in debt	3	14	21	44	33	8	-17
Other long-term liabilities (OLTL)							
Expected change in OLTL	-8	-9	-13	-10	-10	-10	-13
Actual gross debt at 31 March	315	320	328	362	385	383	353
<b>Capital financing requirement</b>	<b>541</b>	<b>555</b>	<b>644</b>	<b>688</b>	<b>721</b>	<b>730</b>	<b>713</b>
<b>Under/(over) borrowing</b>	<b>-226</b>	<b>-235</b>	<b>-316</b>	<b>-326</b>	<b>-336</b>	<b>-347</b>	<b>-360</b>

- B.18. Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the capital finance requirement (CFR) in the preceding year plus the estimates of any additional CFR for 2013/14 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.
- B.19. The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### Prospects for interest rates

- B.20. The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Table B2 provides the Sector central view on interest rates. Appendix B3 sets out a summarised report on global economic outlook and the UK economy.

Table B2: Prospects for interest rates

Annual average	Bank rate %	PWLB borrowing rates (including certainty rate adjustment)		
		5 year %	25 year %	50 year %
December 2012	0.50	1.50	3.70	3.90
March 2013	0.50	1.50	3.80	4.00
June 2013	0.50	1.50	3.80	4.00
September 2013	0.50	1.60	3.80	4.00
December 2013	0.50	1.60	3.80	4.00
March 2014	0.50	1.70	3.90	4.10
June 2014	0.50	1.70	3.90	4.10
September 2014	0.50	1.80	4.00	4.20
December 2014	0.50	2.00	4.10	4.30
March 2015	0.75	2.20	4.30	4.50
June 2015	1.00	2.30	4.40	4.60
September 2015	1.25	2.50	4.60	4.80
December 2015	1.50	2.70	4.80	5.00
March 2016	1.75	2.90	5.00	5.20

- B.21. The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the economy returned to positive growth in the third quarter of 2012. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on the repayment of personal debt, inflation levels eroding disposable income, the general malaise about the economy and employment fears.
- B.22. The primary drivers of the UK economy are likely to remain external. Some 40% of UK exports go to the Eurozone, so the difficulties in this area are likely to continue to hinder UK growth. The US, the main world economy, faces similar debt problems to the UK and has appeared to resolve the difficulties of the fiscal cliff now that the Presidential elections are out of the way. US fiscal tightening and continuing Eurozone problems will continue to depress UK growth and we are likely to see the UK deficit reduction plans slip.
- B.23. This challenging and uncertain economic outlook has several key treasury management implications.
- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty ( a counterparty is the opposite party participating in a financial transaction) risk. This continues to require the use of higher quality counterparties for shorter time periods.
  - Investment returns are likely to remain relatively low during 2013/14 and beyond.
  - Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timings of future borrowing will need to be monitored carefully.
  - There will remain a cost of carry: any borrowing undertaken that results in an increase in the investment portfolio will incur a revenue loss between the borrowing cost and the investment return.

### **Borrowing strategy**

- B.24. The Council is currently maintaining a significantly under-borrowed position. This means that the capital borrowing need (the capital financing requirement) has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. At 31 March 2012, the level of under-borrowing amounted to £175.4m. This strategy is prudent and has proved to be extremely effective as investment returns are at a historic low and counterparty risk remains relatively high.
- B.25. The question remains as to how much longer this under-borrowing strategy will be appropriate and relevant. The Council's current policy of funding external borrowing from internal reserves, thus saving the difference between the cost of capital and the investment return available in the money markets will not hold permanently. At some point in the medium term, the Council will be required to reverse this policy and fund its position from external sources as long term gilt yields and interest rates will eventually rise, thus impacting on the Public Work Loans Board (PWLB) rates.

- B.26. The Council is faced with a loan repayment of £68m in September 2013. How this loan will be replaced and how the current internal borrowing gap will be eventually bridged will depend on market projections over 2013/14 and officers will take advice from the Council's treasury consultant (Sector) as to the future directions of the market over the next year. In the current low interest rate and low gilt yield environment, which is not expected to change in the short term, the Council is well placed to take advantage of this repayment in terms of funding it from reserves, and then refinancing it at the optimum time over the medium term future. To facilitate this, it is therefore recommended that the full County Council agree to reduce the minimum cash level from £135m to £49m.
- B.27. There will be an optimal opportunity to take advantage of financing for the long term at historically low rates, just prior to those long term rates rising upwards. The Council must be strategically poised to take advantage of this opportunity and will assess the timing carefully in order to take full advantage. It is expected that the return to external borrowing will take place on a gradual basis in order to reduce the impact of reverse movements in the market to those anticipated. This underlines the Council's need to maintain a cautious and low risk approach and monitor on a daily basis the economic position against the Council's existing treasury position.
- B.28. Against this background and the risks within the economic forecast, a level of continued caution will be adopted with the 2013/14 treasury management operations. The Chief Finance Officer's staff will continually monitor interest rates in financial markets and adopt a pragmatic approach to future changing circumstances.
- B.29. There are two possible risks in 2013/14:
- The risk of an additional fall in long and short term rates (e.g. due to a marked increase of risks around a further relapse into recession or of risks of deflation). In this case, long term borrowings will be postponed, and potential debt rescheduling from fixed rate funding into short term borrowing will be considered.
  - The risk of a rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks. In this case, the portfolio position will be reappraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively cheap.
- B.30. With regard to the latter risk, the UK is currently benefitting from a "safe haven" status outside the Eurozone, which has supported UK gilt prices and maintained historically low gilt yields (which underpin PWLB borrowing rates). Whilst the UK inflation position has improved significantly, and is expected to return to the Bank of England's Monetary Policy Committee's (MPC's) target of 2%, any deterioration of the UK inflation outlook may have a negative impact on the financial markets view of gilt prices, with a consequent rise in gilt (and therefore PWLB) interest rates. Whilst this outcome is not expected, it remains an outside possibility and highlights the higher risks in the longer term fixed interest rate economic forecasts.
- B.31. Any decisions will be reported to the appropriate decision making body at the next available opportunity.

**Treasury management limits on activity**

B.32. There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive, then they will impair the opportunities to reduce costs and improve performance. The indicators are as follows:

- **Upper limits on variable interest rate exposure**  
This identifies a maximum limit for the level of debt (net of investments) taken out at variable rates of interest.
- **Upper limits on fixed interest rate exposure**  
This is similar to the previous indicator and covers a maximum limit on fixed interest rates.
- **Maturity structure of borrowing**  
These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

B.33. Cabinet is asked to recommend the Council approves the treasury indicators and limits in Table B3.

Table B3: Treasury indicators and limits

	2013/14 to 2017/18		2012/13 year end projection	
	Lower	Upper	£m	
Upper limits on fixed interest rates	100%			
Upper limits on variable interest rates	25%			
Maturity structure of external borrowing	Lower	Upper	£m	
Under 12 months	0%	50%	84	26%
12 months to 2 years	0%	50%	0	0%
2 years to 5 years	0%	50%	0	0%
5 years to 10 years	0%	75%	10	3%
10 years and above	25%	100%	228	71%
<b>Total external borrowing</b>			<b>322</b>	<b>100%</b>

**Policy on borrowing in advance of need**

B.34. The Council will not borrow more than or in advance of its needs purely in order to benefit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved capital finance requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.



**Debt rescheduling**

- B.35. As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (significant premiums can be incurred).
- B.36. The reasons for any rescheduling to take place will include:
- the generation of cash savings or discounted cash flow savings;
  - helping to fulfil the treasury strategy;
  - enhancing the balance of the portfolio (amend the maturity profile or the balance of volatility).
- B.37. 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.
- B.38. All rescheduling will be reported to the Audit & Governance Committee at the earliest meeting following its action

**Annual investment strategy****Investment policy**

- B.39. The Council's investment policy has regard to the CLG's Guidance on Local Government Investments (the Guidance) and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA TM Code). The Council's investment priorities will be security first, liquidity second, then return as the third priority.
- B.40. In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on its lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three rating agencies (Fitch, Moody's and Standard & Poor's (S&P)). Using the Sector ratings service, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.
- B.41. Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. Other information sources used will include the financial press (Financial Times), share prices and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

- B.42. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.
- B.43. Current investment counterparties identified for use in the financial year using currently approved rating criteria are listed in Appendix B5 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty monetary limits are also set out in this appendix. There is only one proposed change with regard to the monetary limits and that is to increase the maximum amount to the Council’s two instant access accounts from £40m to £60m. This will increase revenue by £200,000 per annum at current interest rate levels. Both of these counterparties are partly nationalised and this increase should only apply whilst each counterparty has nationalised status. A new category included within the schedule is pooled corporate bonds, a relatively new treasury investment category which will be further explored by the Chief Finance Officer. No further changes to limits and criteria are recommended, given the Council’s desired prudent risk level.
- B.44. The Chief Finance Officer, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing risks and associated interest rates at the time. All investments will be made in accordance with the Council’s treasury management policy and strategy, and prevailing legislation and regulations. If the list of counterparties and their time or value limits need to be revised, amendments will be recommended to the Audit & Governance Committee.

### **Creditworthiness policy**

- B.45. The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure it:
- maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security (this is set out in the specified and non-specified investment sections below); and
  - has sufficient liquidity in its investments, for this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed (these procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested).
- B.46. The Chief Finance Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria determine an overall pool of counterparties considered to be high quality. It does not define the types of investment instruments to be used.
- B.47. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council’s minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies with one meeting the Council’s criteria and the other not, the institution will fall outside the lending criteria. Credit rating information is supplied by Sector, our treasury consultants, on all active

counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notifications of likely changes), rating outlooks (notification of possible longer term changes) are provided to officers almost immediately after they occur and this information is considered before dealing.

B.48. The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is summarised in Appendix B5.

- Banks (1): good credit quality. The Council will only use banks which:
  - are UK banks; or
  - are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA.
 and have, as a minimum, the following Fitch, Moody's and S&P's credit ratings (where rated):
  - Short term: F1/P1/A1
  - Long term: A-/A3/A-
  - Viability/financial strength: BB+/C (Fitch and Moody's only)
  - Support: 3 (Fitch only)
- Banks (2): part nationalised UK banks, Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks (3): The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiaries: The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies: The Council will use all societies which meet the ratings for banks outlined above.
- Money market funds: AAA rated via all three rating agencies. Up to total £100m. £20m per fund.
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc
- Supranational institutions
- Corporate bonds pooled funds

### **Country and Sector Considerations**

B.49. Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition,

- no more than £50m will be placed with any non-UK country at any time;

- AAA countries only apply as set out in Appendix B6;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

#### **Use of additional information other than credit ratings**

B.50. Additional requirements under the Prudential Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example credit default swaps, negative rating watches or outlooks) will be applied to compare the relative security of differing investment counterparties.

#### **Time and monetary limits applying to investments**

- B.51. All investments will be limited to 364 days years. Further internal restrictions may be applied on recommendations from Sector.
- B.52. The proposed criteria for specified and non-specified investments are shown in Appendix B5 for approval.

#### **Country limits**

B.53. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from all three rating agencies. This restriction does not apply to the UK, should it lose its AAA status.

#### **In-house funds**

B.54. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

#### **Instant access funds**

B.55. The Council will seek to maximise its return on investments by retaining call account deposits in part nationalised banks (Lloyds and RBS) which pay a premium due to their weakened financial strength but remain supported by the UK Government. In addition, the council will utilise money market funds (up to the value of £100m).

#### **Local authorities**

B.56. Loans will be offered to local authorities that seek to borrow cash from alternative sources to the PWLB.

#### **Investment returns expectations**

B.57. The Bank Rate is forecast by Sector to remain unchanged at 0.5% before starting to rise from quarter 4 of 2014. Sector's Bank Rate forecasts for financial year ends (March) are:

2012/13	2013/14	2014/15	2015/16
0.50%	0.50%	0.75%	1.75%

B.58. There are downside risks to these forecasts (i.e., the start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if the Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate. It should be noted that some city predictions put the Bank Rate at 0.5% until the year 2020.

B.59. The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next three years are as follows:

2013/14	0.50%
2014/15	0.60%
2015/16	1.50%

#### **Investment treasury indicator and limit**

B.60. This indicator concerns the total principal funds invested for greater than 364 days. This limit is set with regard to the Council's liquidity requirements and to reduce the need for early liquidation of an investment, and based on the availability of funds after each year end.

B.61. The Council is asked to approve the treasury indicator and limit:

**Table B4: Maximum principal sum invested >364 Days**

	<b>2013/14</b> <b>% of portfolio</b>	<b>2014/15</b> <b>% of portfolio</b>	<b>2015/16</b> <b>% of portfolio</b>
Principal sums invested > 364 days	0	0	0

B.62. This means that no investments should be for longer than 364 days. This keeps the strategy within the Council's desired level of prudent risk.

B.63. For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated overnight deposits.

#### **Icelandic bank investments**

B.64. The Council placed £20m of deposits with two failed Icelandic banks: Glitnir and Landsbanki. Of this £20m, the Council's exposure is £18.5m with the balance attributable to the Police and Crime Commissioner for Surrey. The Audit & Governance Committee receives regular reports on the prospects for recovery of the deposits that are at risk and the efforts being made by the Local Government Association (LGA) and its legal advisors in this regard.

B.65. In order to be prudent, the Council has previously earmarked a balance of £9.5m on the assumption that a proportion of the deposits will not be recovered with the proviso that this write off may be revised based upon latest estimates and the guidance from CIPFA.

- B.66. On 28 October 2011, the Supreme Court of Iceland upheld the District Court judgment in favour of local authority depositors, deciding by a 6-1 majority that local authorities' claims are deposits that qualify in full for priority in the bank administrations. These decisions are now final and there is no further right of appeal.
- B.67. The current position is that 50% of the Landsbanki deposit and 84% of the Glitnir deposits have been repaid, with expected recovery rates now at 100% in respect of both banks (subject to exchange rate fluctuations). The balance owed on each deposit is shown in the Table B5.

Table B5: Balances owed on Icelandic bank deposits

Counterparty	Period (days)	Principal £000	Rate %	Principal repaid £000	Principal outstanding £000
Glitnir	364	5,000	6.25%	4,192	808
Glitnir	366	5,000	6.20%	4,193	807
Landsbanki	732	10,000	5.90%	4,992	5,008
		20,000		13,377	6,623

- B.68. Previous provision has been made within the Council's accounts for an irrecoverable amount regarding the Icelandic bank debt. Given the Supreme Court of Iceland decision, it is now felt prudent to cut the provision in its entirety in order to reflect the confidence in recovering the full outstanding deposit, albeit paid back in instalments over a yet unknown period of time.

### Investment risk benchmarking

- B.69. A development in the revised Code on Treasury Management and the CLG consultation paper, as part of the improvements to reporting, is the consideration and approval of security and liquidity benchmarks. Whereas yield benchmarks are currently widely used to assess investment performance, security and liquidity benchmarks are new reporting requirements. These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or annual report.

### Security

- B.70. The Council's maximum security risk benchmark for the current portfolio, when compared with these historic default tables, is:
- 0.05% historic risk of default when compared to the whole portfolio

### **Liquidity**

B.71. The Council currently restricts deposits with each counterparty to term deposits only, the length of which is based upon individual assessment of each counterparty. The amount of available cash each day should never fall below £15m. A minimum core cash has recently been set at £49m by Cabinet. This provides a safety margin, to help ensure the Council need not borrow to fund daily expenditure. In respect of its liquidity, the Council seeks to maintain the following.

- Bank overdraft: £100,000.
- Liquid short term deposits of at least £15m available with a day's notice.
- Weighted average life benchmark is expected to be three months, with a maximum of one year.

### **Yield**

B.72. The Council benchmarks the return on deposits against the 7-Day LIBID (London Interbank Bid Rate), and reports on this as part of the treasury monitoring reports.

### **Performance indicators**

B.73. The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy and effectiveness of the treasury management function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. The performance indicators to be used for the treasury management function are:

- borrowing: actual rate of borrowing for the year less than the year's average rate relevant to the loan period taken; and
- investments: internal returns above the 7-day LIBID rate.

B.74. These indicators will be reported to the Audit & Governance Committee in the quarterly and half yearly reports, due after 30 September 2012, and the Treasury Management Annual Report for 2013/14.

### **End of year investment report**

B.75. At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Management Report.

### **External fund managers**

B.76. The Council does not currently employ an external fund manager.

### **Minimum revenue provision**

B.77. The Council's policy on minimum revenue provision (MRP) is shown in Appendix B7.

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**Appendices:**

Appendix B.1	Prudential indicators - summary
Appendix B.2	Prudential indicators – details
Appendix B.3	Global economic outlook and the UK economy
Appendix B.4	Treasury management scheme of delegation
Appendix B.5	Institutions
Appendix B.6	Approved countries for investments
Appendix B.7	Annual minimum revenue provision (MRP) policy statement

**Sources and background papers:**

CIPFA Prudential Code for Capital Finance

CIPFA Treasury Management in the Public Services: Code of Practice

Investment guidelines under section 15(1)(a) of the Local Government Act 2003

Audit Commission: 'Risk & Return: English Local Authorities and the Icelandic Banks'

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