Appendix A

1.0 Treasury Management Strategy 2011/12

1.1 This Strategy Statement has been prepared in accordance with the revised Treasury Management Code. This requires the Council's Treasury Management Strategy to be approved annually by the Council but also there is a requirement to produce a mid year report, plus there will be monitoring reports and regular reviews to Members in both Executive and Scrutiny functions. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

1.2 The Act therefore requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.3 **Borrowing Strategy**-The Operational and Authorised Borrowing Limits have to be approved before the start of each financial year.

1.4 It is anticipated that from 2011/12 'supported borrowing' will be undertaken by SBC's General Fund on behalf of the HRA. 'Supported borrowing', means the Government will pay the interest to the HRA via the HRA 'Subsidy Determination'. It is anticipated that the borrowing will be from the Public Works Loan Board (PWLB). Currently their rates are around 5.2% for a twenty five year loan.

1.5 The limits proposed for 2011/12 are:-

- Overall Borrowing Limit - £49.6million
- Short Term Borrowing Limit - £15million
- Variable Interest Proportion Limit - 100%

1.6 Based on the current capital programme resourcing projections, the Council will need to borrow to maintain its existing fixed assets. It is anticipated that the Council will need to borrow £2,250,000 in 2011/12. The borrowing to fund the resources shortfall could be accessed from the Public Works Loan Board (PWLB). The current interest rate for borrowing over 25 years is 5.2%. This would mean a cost of £92,000 for every million borrowed (full year cost for interest and principal).

1.7 **Prospect for Interest Rates**-The base rate at the start of the financial year was 0.5% while this is a very low rate there are mixed views as to how quickly rates will rise. Our Treasury Advisor, Sector 2010 forecast is that rates will rise to 1.0% in 2011 and continue to rise in 2012, to 1.75%. The current interest rates for investments are:

One month	0.40%
Three months	0.50%
Six months	0.80%
One Year	1.20%

The Council has budgeted in 2011/12 for an average return on investments of 0.94%. During 2010/11, the banking system has become slightly more stable, however interest rates on various call accounts still realise a better return than fixed rate deposits. While some money has been fixed during the year, the majority of investments have been put in call accounts. Once market rates for fixed term deposits over a range of periods increase, then funds can once again be invested over a range of periods. As result of the unusual market patterns and historically low rates of return the Council amending its Prudential Indicators for the 2010/11 mid-year review reducing the limit on long term fixed deposits from £10,000,000 to £2,000,000.

2.0 Investment Strategy

2.1 The Council is required to prepare an Annual Investment Strategy. The Council will have regard to the Department of Communities and Local Government's (CLG) Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

(a) the security of capital and

(b) the liquidity of its investments.

2.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

2.3 The borrowing of monies purely to invest or on-lend in order to make a return is unlawful and this Council will not engage in such activity.

2.4 There is currently a preference to invest with UK banks which have the backing of the British Government, (Appendix A attachment 3.) However it is getting progressively more difficult to find names which meet the stringent criteria in place. The Council only invests in counterparties with a high credit rating and in specified countries as listed in Appendix A attachment 4. In order to allow flexibility in the Council's portfolio of investments, it may be prudent to spread investments over a one to five year period, albeit in the current climate this is limited to £2,000,000 of the Council's investments. Therefore it is proposed that;

- The lending limit remains at £5,000,000 per group. This was amended for the mid-year review during 2010/11.

- Investments can be dealt for up to five years with the Strategic Director (Resources) approval and limited to those institutions which appears on the Debt Management Office (DMO) web site, (Appendix A, Attachment 3)

2.5 The principal consideration when undertaking an investment is the Council's cash flow requirements, i.e. investments are scheduled to mature on a date when it is known large cash flows will occur. When surplus cash becomes available for investment, it is used to maintain a balanced investment portfolio. As at the end December 2010 the total investments were £18,640,000. Average return to date on all investments this year being 0.93%.

2.6 A list of the types of instruments comprising Specified and Non-Specified Investments is attached at Appendix A, Attachment 3.

3 Creditworthiness policy

3.1 As reported in the 2010/11 Strategy, the Council uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays : -

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources

3.2 The Council is not proposing to use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. This is because Moodys have a tendency to give much lower ratings than the other two agencies. Officers are content that the Sector model provides the Council with a sophisticated tool. To illustrate the impact of the CIPFA approach on the Council's investments , adopting the lowest rating approach would have meant the Council having had to find other opportunities for £8,040,000 of its portfolio as at 31 December 2010, as illustrated below.

Institution	Sector approach	Lowest rating	Limit
Santander Group-consisting of			Group limit £5,000,000
Alliance and Leicester	Allowed	Not allowed	**£5,000,000**
Nationwide	Allowed	Not Allowed	**£3,040,000**
Bank of Scotland	Allowed	Allowed	£2,590,000
Nat West	Allowed	Allowed	£3,010,000
Handlesbanken	Allowed	Allowed	£5,000,000
Total			**£18,640,000**

3.3 This is also at a time when it is increasingly difficult to find suitable counterparties and would therefore be unworkable and leave the Council with few banks on its approved lending list and create a new risk around large proportions of our investments being held in even fewer banks.

3.4 Credit ratings will be monitored whenever an investment is to be made, using the most recent information. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list. However, investments already with the counterparty are likely to remain invested as it would be very expensive and potentially impossible to have the funds returned prematurely. However, the Chief Finance Officer will review the risk and penalties involved in order to determine whether an investment should be returned.

3.5 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

4 Country limits

4.1 The Council has determined that it will only use approved counterparties from selected countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide) The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix A attachment 4. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

5 Current Investments

5.1 At the end of December the Council had £18,640,000 on deposit with the institutions detailed in 3.2 above.

6 Policy on borrowing in advance of need

6.1 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 and that the Council can ensure the security of such funds.

6.2 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
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

7 End of year investment report

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

8 Policy on the use of external service providers

8.1 In October 2009, the Council went out to tender for its treasury management advisors. As a result of which, Sector Treasury Services was awarded a three year contract.

8.2 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.

8.3 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.

9 Scheme of delegation and role of s151 officer

Please see Appendix A attachment 5