

**TREASURY MANAGEMENT STRATEGY, MRP STRATEGY AND ANNUAL
INVESTMENT STRATEGY 2013/14**

1. Background

- 1.1 The Council is required to operate a balanced budget, with cash raised during the year sufficient to 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.
- 1.2 Surplus monies are invested in counterparties or instruments commensurate with the Council's risk appetite, providing adequate security and liquidity initially, before considering investment return.
- 1.3 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.
- 1.4 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 the Council's risk or cost objectives.
- 1.5 The Chartered Institute of Public Finance and Accountancy (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."
- 1.6 The Council is responsible for its treasury decisions, activity and risk appetite. The successful identification, monitoring and control of risk are integral elements of treasury management, including credit and counterparty risk, liquidity risk, market risk, interest risk, refinancing risk and legal and regulatory risk.
- 1.7 The Treasury Management Strategy takes into account the impact of the Council's proposed Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected Treasury position, the Prudential Indicators and the outlook for interest rates. In addition the current market conditions are factored into any decision making process.
- 1.8 As the Council is responsible for housing, Prudential Indicators relating to Capital Expenditure, financing costs and the Capital Financing Requirement will be split between the Housing Revenue Account (HRA) and the General Fund. The impact of any new capital investment decisions on housing rents will also need to be considered.

2. Reporting Requirements

2.1 The Council is required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by Committee before being recommended to the Council.

2.2 **Prudential and Treasury Indicators and Treasury Strategy** (this report) –
The first and most important report and covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision (MRP) policy (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).

2.3 **An annual treasury report** that provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

2.4 **A mid-year treasury management report** to update Councillors on the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision or amendment.

3. Treasury Management Strategy for 2013/14

3.1 The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the CIPF Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years and to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

3.2 The Act requires local authorities to set out their treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by investment Guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

3.3 The Department of Communities and Local Government (CLG) has issued revised investment guidance that came into effect from 1 April 2010, and the Council has adopted the recommendations of the guidance.

3.4 The strategy for 2013/14 covers two main areas:

Capital Issues

- the capital plans and the prudential indicators; and
- the minimum revenue provision (MRP) strategy.

Treasury Management Issues

- the current portfolio position;
- macroeconomic outlook and prospects for interest rates;
- the General Fund and HRA borrowing requirement and strategy;
- policy on borrowing in advance of need;
- debt rescheduling and repayment;
- the use of the Council's resources and expected investment balances;
- the Annual Investment Strategy and Investment Policies;
- Investment Counterparty Selection Criteria
- creditworthiness policy;
- use of additional information other than credit rating;
- policy on use of external service providers; and
- treasury indicators which limit the treasury risk and activities of the Council.

3.5 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CLG MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

4. Treasury Management Consultants

4.1 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.

4.2 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.

4.3 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 deposits (overnight to three months) in order to benefit from the compounding of interest.

5. Member and Officer Training

5.1 The CIPFA Code requires the responsible officer, the Chief Finance Officer, to ensure that Councillors with responsibility for treasury management receive adequate training in treasury management.

5.2 Training will be arranged for Councillors as required. The training needs of treasury management officers are periodically reviewed.

6. Current Portfolio Position

- 6.1 Table 1 below shows the Council's investments and borrowing balances as at 31 December 2012, including the average life and the Rate of Return.

Table 1: Council's treasury position at 31 December 2012

	Principal Outstanding 31/12/2012 £'000s	Average Rate of Return 31/12/2012 %	Average Life as at 31/12/2012 (yrs)
Fixed Rate Funding:			
PWLB	285,912	3.55	38.96
Variable Rate Funding:			
PWLB	0	0	0
Market	40,000	4.02	55.89
Total Debt	325,912	3.61	41.04
Investments			
In-House	95,708	1.79	
External Managers:			
Investec	39,050	1.03	
Total Investments	134,758	1.57	

- 6.2 The sum invested broadly represents the reserves, provisions and balances that the Council holds together with the impact of any difference between the collection of income and expenditure (working capital). Included in the Council managed cash balances is £6m relating to the Pension fund.

7. Macroeconomic Outlook and Prospects for Interest Rates

- 7.1 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 repayment of personal debt, inflation eroding disposable income, general malaise about the economy and employment fears.
- 7.2 The primary drivers of the UK economy are likely to remain external. 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, but urgently needs to resolve the fiscal cliff now that the Presidential elections are out of the way. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth and is likely to see the UK deficit reduction plans slip.

7.3 This challenging and uncertain economic outlook has several key treasury management implications:

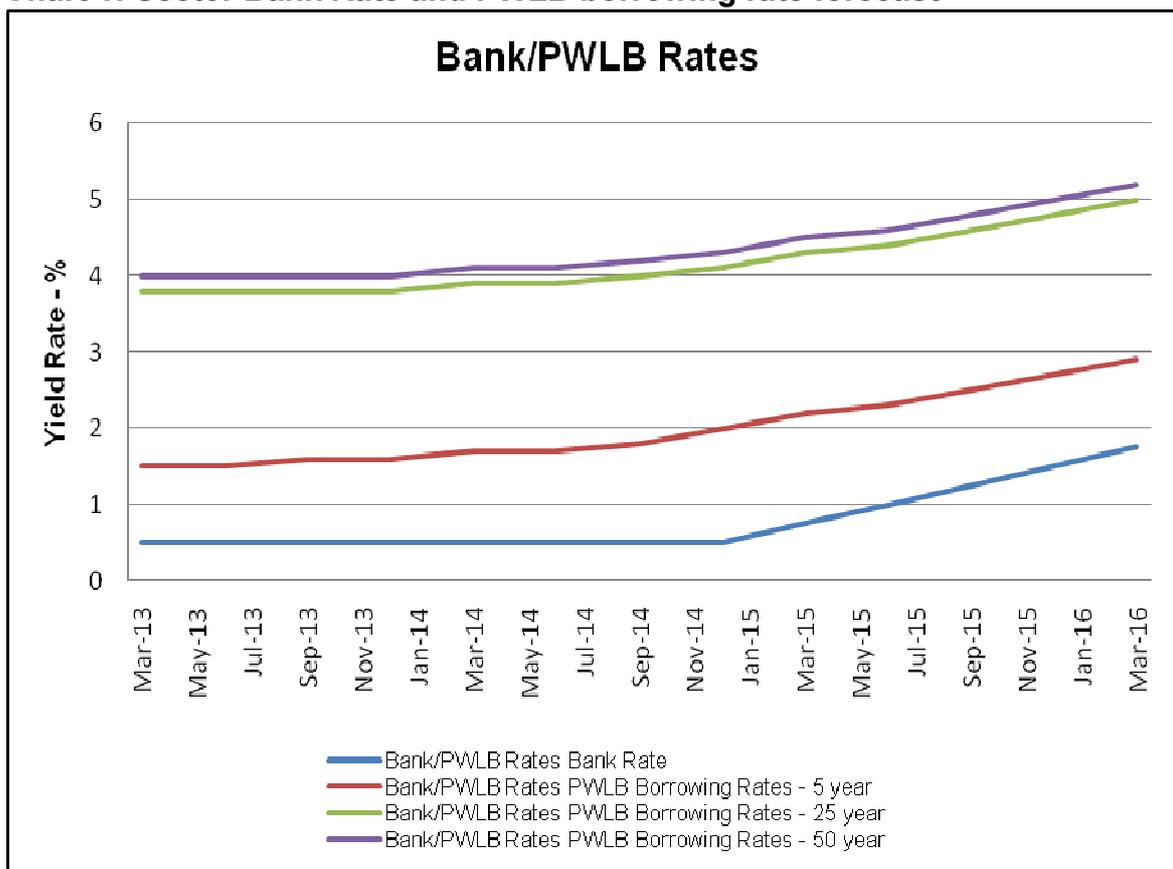
- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2013/14 and beyond;
- Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully; and
- There will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

7.4 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. From 1 November 2012, the Government reduced by 20 basis points the interest rates on loans from PWLB (the Certainty Rate) to local authorities who provide the required information on their plans for long-term borrowing and associated capital spending. Interest rate forecasts have been adjusted to reflect this lower borrowing rate available to the Council. Table 2 and Chart 1 provide Sector’s central view on interest rates.

Table 2: Sector Bank Rate and PWLB borrowing rate forecast

As at Date	Bank Rate %	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year %	25 year %	50 year %
Jun-13	0.5	1.5	3.8	4.0
Sep-13	0.5	1.6	3.8	4.0
Dec-13	0.5	1.6	3.8	4.0
Mar-14	0.5	1.7	3.9	4.1
Jun-14	0.5	1.7	3.9	4.1
Sep-14	0.5	1.8	4.0	4.2
Dec-14	0.5	2.0	4.1	4.3
Mar-15	0.75	2.2	4.3	4.5
Jun-15	1.0	2.3	4.4	4.6
Sep-15	1.25	2.5	4.6	4.8
Dec-15	1.5	2.7	4.8	5.0

Chart 1: Sector Bank Rate and PWLB borrowing rate forecast



7.5 **Appendix 1A** draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates.

7.6 As interest rate forecast shows that the UK base rate is forecast to remain at 0.5% until 2015, this would mean that short term rates are likely to remain significantly lower than long term rates throughout 2013/14 and beyond.

8. The Capital Expenditure Plans 2013/14 – 2015/16

8.1 The Council’s Housing and General Fund capital expenditure plans, together with Balances and Reserves, are the key drivers of treasury management activity. The estimates for Capital expenditure, and its funding based on current proposed Revenue Budget and Capital Programmes, are reflected in prudential indicators, which are designed to assist Councillors overview and confirm capital expenditure plans. The Prudential Indicators are included in **Appendix 1B** of this report.

8.2 Table 3 below shows the proposed capital expenditure over the coming three financial years. It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and, in the case of the HRA, housing rent levels.

Table 3: Proposed Capital Expenditure 2013 to 2016

Capital expenditure £'000s	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
General Fund	97,178	67,587	74,579	32,017	5,475
HRA	30,968	43,350	83,240	74,090	45,620
HRA Settlement	265,912	-	-	-	-
Total	394,058	110,937	157,819	106,107	51,095
Financed by:					
Capital Receipts	-	6,037	12,429	5,700	1,920
Capital Grants and Contributions	79,728	54,161	96,990	33,557	7,225
Revenue contributions	1,440	607	-	-	-
Capital Reserves	-	1,195	-	-	-
HRA Resources	7,638	33,850	42,260	45,250	41,950
Net financing need for the year	305,252	15,087	6,140	21,600	-

- 8.3 The estimated financing need for the year in Table 3 represents a shortfall of resources resulting in a requirement to borrow. This underlying need to borrow is known as the Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
- 8.4 Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.
- 8.5 Sufficient headroom has been provided within the Authorised Limit on external borrowing to ensure that any major capital investment projects where finance has yet to be finalised, are not restricted by this statutory limit. The limit covers any short term borrowing for cash flow purposes as well as long term borrowing for capital projects, finance leases PFI initiatives as well as any unforeseen incidences where expected capital receipts are not forthcoming due to unexpected economic factors.
- 8.6 Table 3 includes £266m borrowed in March 2012 to finance the HRA reform.

9. The Council's Borrowing Strategy and Borrowing Requirement

- 9.1 The decision to borrow is a treasury management decision and is taken by the Chief Finance Officer under delegated powers of the Council's constitution. The key

objective of the Council's borrowing strategy is to secure long term funding for capital projects at borrowing rates that are as low as possible. This can result in a trade off of short term returns on deposits to obtain the best possible rate on long term borrowings.

9.2 Treasury management, and borrowing strategies in particular, continues to be influenced by the absolute level of borrowing rates and also the relationship between short and long term interest rates. Rate forecasts indicate that interest rates will remain low until 2015 which creates a "cost of carry" between what is paid on the borrowing and what is earned on the investment for any new longer term borrowing. This is because borrowing requirements are generally over a long term period of up to 25 years, while cash is currently being invested for a maximum of a year.

9.3 As a result the Council will seek to maintain an under-borrowed position throughout 2013/14. This means that the CFR will not be fully funded with loan debt during the year as cash supporting the Council's reserves, balances and cash flow will be used as a temporary measure. This strategy is prudent as it reduces the "cost of carry" while investment returns remain low, as well as reduces the Council's counterparty risk, which continues to be high and is likely to will continue throughout 2013/14.

9.4 As circumstances can change during the year, the Chief Finance Officer will monitor interest rates in financial markets and adopt a flexible approach to any changes:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively cheap.*

9.5 The Council's borrowing strategy will give consideration to the following when deciding to take-up new loans:

- Use internal cash balances while the current rate of interest on investments remains at an all-time low. However consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if long term borrowing rates begin to increase more than forecast;
- Using long term fixed rate market loans where rates are significantly less than PWLB rates for the equivalent maturity period;
- Using Public Works Loan Board (PWLB) short term variable rate loans;
- Maintain an appropriate balance between PWLB and market debt in the debt portfolio;
- Use short dated PWLB fixed rate loans where rates are expected to be significantly lower than rates for longer period;

- Ensure that new borrowings are drawn at periods when rates are expected to be low; and
- Consider the issue of stocks and bonds if appropriate.

9.6 The Council has £40m of loans which are Lender's Options Borrower's Option (LOBO) and all of them will be in their call period during 2013/14. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower (the Council) can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the Lender's discretion.

9.7 As LOBOs currently make up 12.3% of the total external debt portfolio, this is not a significant risk. Any LOBO called will have the default position of repayment of the LOBO without penalty, i.e. the revised terms will not be accepted.

10. Self Financing

10.1 HRA Debt

Central Government completed the reform of the HRA subsidy system on 28 March 2012. The Council is required to recharge interest expenditure and income attributable to the HRA in accordance with Determination issued by the CLG.

The Determinations do not set out a methodology for calculating the interest rate to use in each instance. The Council is therefore required to adopt a policy that will set out how interest charges attributable to the HRA will be determined. The CIPFA Treasury Management Code of Practice recommends that authorities present this policy in the annual TMSS.

On 1 April 2012, for treasury management of the General fund and HRA debt, the Council adopted a two loans pool approach for long term debt.

- The full £265.9m of PWLB long term debt from the HRA reform settlement is allocated to the HRA, with the remaining £60.0m of debt allocated to the General Fund (GF); and
- All future long term loans are allocated into either the HRA or GF pool.

A breakdown of the HRA borrowing is provided in table 4 below:

Table 4: HRA borrowing:

Loan Type	Loan Amount	Maturity profile	Interest Rate
	£'000s	Yrs	%
PWLB	50,000	29	3.51
PWLB	50,000	39	3.52
PWLB	50,000	47	3.49
PWLB	50,000	48	3.48
PWLB	65,910	49	3.48
Total	265,910		

A debt cap of £277m has been set for the HRA. The CLG have confirmed that the debt cap, now set, cannot be breached. Good treasury management is required under self-financing to support the achievement of business objectives and to conform to the requirements of the debt cap as should the cap be breached the Section 151 officer and the Council as a whole would be in breach of the law.

10.2 HRA Investments

Cash balances held by the HRA will be invested as part of the Council's overall treasury strategy. Cash balances will generally earn the average rate of the Council's investments, which will be calculated at the financial year end.

Where there is agreement between the Chief Finance Officer and the Corporate Director of Housing & Environment, individual investments can be ring-fenced for the HRA, with the allocations made within the Council's overall treasury strategy requirements.

For further details please refer to the HRA Business Plan.

11. Policy on borrowing in advance of need

11.1 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 within forward approved CFR 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.

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

11.3 Current forecasts indicate that it is unlikely that the Council will seek to borrow in advance in 2013/14.

12. Debt rescheduling and repayment

12.1 As short term borrowing rates are usually 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, any savings will need to be based on the current treasury position and the size of the cost of debt repayment (premiums incurred).

12.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy; and
- enhance the balance of the portfolio (amend the maturity profile).

12.3 Consideration will be given to identify any residual potential to make 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.

12.4 Any rescheduling will be reported to the Council at the earliest meeting.

12.5 In April 2013 a £10m PWLB loan, borrowed at 4.07%, matures. Given the high level of cash currently held, the loan is expected to be repaid and will not immediately be replaced. This will reduce the General Fund borrowing to £50m.

13. Minimum Revenue Provision Policy Statement

13.1 In accordance with Statutory Instrument 2008 number 414 and new guidance issued by the Government under section 21 (1A) of the Local Government Act 2003 a statement on the Council's policy for its annual MRP needs to be approved before the start of the financial year.

13.2 The Council are asked to approve the Minimum Revenue Provision Statement set out in Appendix 1C.

14. The use of the Council's Resources and expected investment balances

14.1 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £'000s	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Fund balances / reserves	160,000	180,000	154,000	146,000	136,000
Capital receipts	7,000	15,000	6,000	4,000	5,000
Provisions	11,000	11,000	11,000	11,000	11,000
Total core funds	177,000	206,000	171,000	161,000	152,000
Working capital*	77,000	88,000	88,000	88,000	88,000
External borrowing	336,000	326,000	350,000	364,000	364,000
Capital financing requirement	-485,000	-496,000	-500,000	-503,000	-493,000
Expected investments	104,000	125,000	109,000	110,000	111,000

*Working capital balances shown are estimated year end; these may be higher mid-year.

15. Annual Investment Strategy and Investment Policies

15.1 Investment policy

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").

15.2 These guidelines do not apply to either trust funds or pension funds, which operate under a different regulatory regime. The key intention of the guidance is to maintain the current requirement for councils to invest prudently. The Council's investment priorities are:

- **security** of the investment capital;
- **liquidity** of the investment capital; and
- an optimum **yield** which is commensurate with security and liquidity.

15.3 In accordance with the above, 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 the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings and watches published by all three ratings agencies with a full understanding of what the ratings reflect in the eyes of each agency. Using the Sector ratings service, banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

15.4 Further, 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.

15.5 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. This is encapsulated within the credit methodology provided by the advisors, Sector.

15.6 Other information sources used will include the financial press 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.

15.7 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.

15.8 The intention of the strategy is to provide security of investment and minimisation of risk.

16. Security of Capital - the Creditworthiness Policy

16.1 This Council applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from the most creditworthy countries.

16.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments.

16.3 The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years (this is for AAA rated Government debt or its equivalent)
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No colour not to be used

16.4 The Sector creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

16.5 Typically the minimum credit ratings criteria the Council will use is the short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

16.6 All credit ratings will be monitored daily. 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 / investment scheme 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 spreads 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 Council's lending list.

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

17. Use of additional information other than credit ratings.

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

18. Time and monetary limits applying to investments.

18.1 The time and monetary limits for institutions on the Council's counterparty list are set out in appendix 1D (these will cover both specified and non-specified investments).

18.2 The time limits and monetary limits set out in appendix 1D are the operational criteria in normal times. At times of heightened volatility, risk and concern in financial markets, this strategy may be amended by temporary operational criteria further limiting investments to counterparties of a higher creditworthiness and / or restricted time limits.

19. Use of other Local Authorities

19.1 Where the investment is a straightforward cash loan the Local Government Act 2003 s13 suggests that the credit risk attached to English and Welsh local authorities is an acceptable one. The Council will limit its lending to local authorities in England and Wales.

20. Use of Multilateral Development Banks

20.2 S15 of the Local Government Act 2003 SI 2004 no. 534 amended provides regulations to clarify that investments in multilateral development banks were not to be treated as being capital expenditure. Should the Council invest in such institutions then only such institutions with AAA credit rating and government backing would be invested in consultation with the Council's treasury adviser and the S151 Officer.

21. Use of Brokers

21.1 The Council deals with many of its counterparties directly through its daily dealings. From time to time the Council will use the services of brokers to act as agents between the Council and its counterparties when lending or borrowing. However no one broker will be favoured by the Council. The Council will ensure that sufficient quotes are obtained before investment or borrowing decisions are made via brokers.

22. Country limits and Use of Foreign Banks

- 22.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA (*excluding the United Kingdom*) from Fitch. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy. This will ensure that the Council's investments are not concentrated in too few counterparties or countries.
- 22.2 Given the strength of some foreign banks the Council will invest in strong non UK foreign banks, whose sovereign and individual ratings meet its minimum criteria of AAA.
- 22.3 During 2013/14 it is possible that the United Kingdom's sovereign rating could be downgraded by one or more ratings agencies. The TMSS will therefore not set a minimum sovereign rating of AAA for the United Kingdom so as to ensure continuity of being able to invest in UK banks if such a downgrade were to occur

23. Investment strategy

- 23.1 **In-house funds.** 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).
- 23.2 **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 1 of 2015. Bank Rate forecasts for financial year ends (March) are:
- 2012/13 0.50%
 - 2013/14 0.50%
 - 2014/15 0.75%
 - 2015/16 1.75%
- 23.3 There are downside risks to these forecasts (i.e. 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 Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.
- 23.4 Investment instruments identified for use in the financial year are listed in Appendix 1D under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.
- 23.5 Alternative financial instruments such as derivatives will not currently be considered but future use will remain under review.

24. Provisions for Credit-related losses

- 24.1 If any of the Council's investments appeared at risk of loss due to default, (i.e. a credit-related loss and not one resulting from a fall in price due to movements in

interest rates) the Council will make revenue provision of an appropriate amount. Where there is a loss of the principal amount borrowed due to the collapse of the institution, the Council will seek legal and investment advice.

25. End of year investment report

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

26. External fund managers

26.1 It is the Council's policy to use external fund managers for part of its investment portfolio. The fund managers will use both specified and non-specified investment categories, and are contractually committed to keep the Council's investment strategy. The level of external balances is under constant review as the level of capital receipts and available cash flow diminishes. The performance of each manager is reviewed quarterly by the Chief Finance Officer or delegated officers and the Council's treasury advisers.

26.2 The Council currently uses Investec as a fund manager with £39m of the Council's funds managed on a segregated mandate basis. In selecting the institutions to include in their counterparty listing, it is the external manager's policy to maintain a list of counterparties and assets based on the Council's set minimum criteria. This list is approved by their specialist credit team who independently research all potential counterparties before inclusion and regularly monitor and update to ensure that any change in credit worthiness and valuation is captured.

26.3 The fund manager provides the Council with a periodic outlook on fund returns. For 2012/13, the return achieved for nine months to 31 December 2011 is 1.0%, compared to a best case scenario of 2.0%. This scenario is based on the recent trend of the MPC rate which has continuously remained at 0.5% with predictions for a rate change now not until late 2013.

26.4 Investec will continue to use instruments including Floating Rate Notes and supranational bonds, in addition to gilts in order to increase returns of the portfolio. However they expect to see higher yield before establishing a position.

27. Pension Fund Cash

27.1 London Borough of Barking and Dagenham manages its Pension Fund's in-house cash under a Service Level Agreement, with its share of interest earnings credited to the Pension Fund.

27.2 From October 2013 the Pension Fund will have a separate bank account for investment purposes, Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.