POLICE AND CRIME COMMISSIONER **4**

NORTHUMBRIA POLICE

JOINT INDEPENDENT AUDIT COMMITTEE **27 MARCH 2013**

TREASURY POLICY STATEMENT 2013/14 TO 2015/16

REPORT OF THE TREASURER (PCC)

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1 Purpose of the Report

1.1 The report asks the Committee to approve the Treasury Policy Statement and Strategy for 2013/14 to 2015/16 for presentation to the Police and Crime Commissioner.

2 Background

2.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) has produced the Code of Practice on Treasury Management (the Code) which represents best practice in Treasury Management. By adopting the attached Treasury Policy Statement and Strategy for 2013/14 to 2015/16 the Commissioner contributes towards achieving best practice.

2.2 Part 1 of the Local Government Act 2003 specifies the powers of local authorities to borrow for any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs. For the purpose of the Local Government Act 2003 Police and Crime Commissioners are classified as local authorities. The CIPFA Prudential Code for Capital sets out a range of prudential and treasury indicators that must be calculated to ensure borrowing is affordable, prudent and sustainable. The Prudential Code also refers to the need for a clear and integrated treasury strategy.

2.3 In addition, under Section 15 of the Local Government Act 2003, local authorities are required to have regard to the CLG's guidance on Local Government Investments. This document stipulates the requirement for an annual investment strategy to be integrated into the Commissioner's Treasury Strategy.

3. Treasury Strategy

3.1 CIPFA's Code requires the setting out of the responsibilities of the Commissioner, Committee members, officers and treasury advisors to allow a framework for reporting and decision making on all aspects of treasury management. To achieve this, the Committee is asked to consider a Treasury Strategy for 2013/14 - 2015/16. The Strategy is attached as Appendix 2 to this report.

3.2 The Treasury Strategy for 2013/14 to 2015/16 covers the specific activities proposed for the next three years in relation to both borrowing and investments and ensures a wide range of advice is taken to maintain and preserve all principal sums, whilst obtaining a reasonable rate of return, and that the most appropriate borrowing is undertaken. The primary objective of the investment strategy is to maintain the security of investments at all times.

3.3 The Treasury Strategy complies with the requirements of the Code, the Prudential Code for Capital Finance in Local Authorities and Part 1 of the Local Government Act 2003.

4 Equal Opportunities Implications

4.1 It is considered that there are no equal opportunities implications arising from the report.

5 Human Rights Implications

5.1 It is considered that there are no human rights implications arising from the report.

6 Risk Management Implications

6.1 The Treasury Policy and Strategy recommended for approval have been prepared with the aim of maintaining the security and liquidity of investments to ensure that the Commissioner's principal sums are safeguarded. Maximising income is considered secondary to this main aim.

7 Financial Implications

7.1 There are no financial implications directly arising from the contents of this report. Any income and expenditure within the scope of the report is already included in the agreed revenue budget.

8 Recommendation

8.1 This report asks the Committee to review and recommended the implementation of the attached three year Treasury Policy Statement and Strategy.

9 Background Information

9.1 The following documents have been used in preparation of the report:

- Local Government Act 2003
- CLG Guidance on Local Government Investments
- CIPFA's Prudential Code for Capital
- CIPFA's Code of Practice on Treasury Management
- The Commissioner's approved Treasury Management Practice Statements
- Sector's Treasury Management Strategy template

Appendix 1

Treasury Policy 2013/14 to 2015/16

1. Approved Activities of the Treasury Management Operation

1.1 CIPFA has produced the Code of Practice on Treasury Management in Public Services (the Code), which represents best practice. Treasury management activities are defined by CIPFA as:

> "The management of the organisation's investments and cash flows, its bankings, 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".

1.2 Gateshead Council provides advice to the Police and Crime Commissioner for Northumbria and undertakes investment and borrowing on behalf of the Commissioner under powers delegated to the Treasurer and regulated through a Service Agreement. The necessary power for this exists within Section 113 of the Local Government Act. In respect of this the Treasurer to the Commissioner is also Gateshead Council's Treasurer. When undertaking treasury activities on behalf of the Commissioner, Gateshead Council operates an integrated treasury strategy and has adopted the Revised CIPFA Code of Practice for Treasury Management in the Public Services.

2. Treasury Strategy

2.1 The Commissioner 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 the risk implications for the Commissioner.

2.2 The Treasury Strategy encompasses the requirements of CIPFA's Revised Treasury Management Code of Practice, CIPFA's Prudential Code and the CLG's Guidance on Local Authority Investments. This document stipulates the requirement for an annual investment strategy to be integrated into the Commissioner's Treasury Strategy Statement.

2.3 The Treasury Strategy covers the following:

a) treasury limits in force which will limit the treasury risk and activities of the Commissioner, including prudential and treasury indicators;
b) prospects for interest rates;
c) the borrowing strategy;
d) debt rescheduling;
e) policy on borrowing in advance of need;
f) the investment strategy; and
g) the policy on the use of external service providers.

The strategy for 2013/14 to 2015/16 is attached at Appendix 3.

3. Prudential and Treasury Indicators

3.1 Under Part 1 of the Local Government Act 2003 the Commissioner may borrow money

(a) for any purpose relevant to its functions under any enactment, or
(b) for the purposes of the prudent management of its financial affairs.

3.2 Under the requirements of the Prudential Code and Code of Practice for Treasury Management in the public services the following indicators have been adopted:

- Compliance with the Code of Practice for Treasury Management in the public services;
- Calculations of:
  - Authorised limit;
  - Operational boundary;
  - Actual external debt;
  - Upper limit on fixed interest rate exposures;
  - Upper limit on variable interest rate exposures;
  - Maturity structure of borrowing; and
  - Upper limits for principal sums invested for periods of over 364 days.

3.3 Given the link to the budget and capital programme, these indicators were approved by the Commissioner on 27th February 2013 as part of the 2013/14 Budget and Council Tax Level report. For completeness, the approved indicators are also attached to the Treasury Strategy at Appendix 3.

Annual Investment Strategy

4.1 Part 1 of the Local Government Act 2003 relaxed the constraints under which local authorities can invest.

4.2 The CLG has issued guidance to supplement the investment regulations contained within the Local Government Act 2003. It is also referred to under Section 15 (1) of the 2003 Local Government Act which requires authorities to “have regard (a) to such guidance as the Secretary of State may issue and (b) to such other guidance as the Secretary of State may by regulations specify”. The guidance encourages authorities to invest prudently but without burdening them with the detailed prescriptive regulation of the previous regime.

4.3 Central to the guidance and the Code is the need to produce an annual investment strategy. This is included as Section 6 of the Treasury Strategy in Appendix 3.

4.4 The Annual Investment Strategy document will include:

- The Commissioner’s risk appetite in respect of security, liquidity and return;
- The definition of ‘high’ and ‘non-high’ credit quality to determine what are specified investments and non-specified investments;
- Which specified and non specified instruments the Commissioner will use, dealing in more detail with non specified investments given the greater potential risk;
- The categories of counterparties that may be used during the course of the year e.g. foreign banks, nationalised/part nationalised banks, building societies;
- The types of investments that may be used during the course of the year;
- The limit to the total amount that may be held in each investment type;
- The Commissioner’s policy on the use of credit ratings, credit rating agencies and other credit risk analysis techniques to determine creditworthy counterparties for its approved lending list and how the Commissioner will deal with changes in ratings, rating watches and rating outlooks;
- Limits for individual counterparties, groups and countries ; and

- Guidelines for making decisions on investments and borrowing.

5. Policy on Interest Rates Exposure

5.1 The 2013/14 Budget and Council Tax Level report, approved by the Commissioner on 27th February 2013, sets treasury limits for the maximum and minimum level of exposure to fixed and variable interest rates. The use of any financial instruments, such as derivatives, to mitigate interest rate risks will be considered on an individual basis and the Treasurer will require approval from the Commissioner prior to entering into any arrangement of this nature.

6. Policy on External Managers

6.1 Treasury management advisers (Sector Treasury Services) have been appointed to assist in achieving the objectives set out in the Treasury Policy Statement. The Treasurer has not appointed external investment fund managers to directly invest the Commissioner's cash. This position is subject to an annual review using the CIPFA Treasury Management benchmarking return to assess the performance of authorities using external fund managers. Based on the results of the most recent benchmarking return the Treasurer has taken the view that the appointment of external fund managers is not justified in terms of the expected net return over what could be achieved internally. This view is supported by Sector.

7. Policy on Delegation, Review Requirements and Reporting Arrangements

7.1 It is the Commissioner's responsibility under the Code to approve a treasury policy statement.

7.2 The Commissioner delegates the review of the policy, monitoring of the performance of the treasury management function and the scrutiny of treasury management strategy and policies to the Audit Committee, and the execution and administration of treasury management decisions to the Treasurer. Any proposals to approve, adopt or amend policy require the consent of the Commissioner and are matters for the Commissioner to determine.

7.3 The Commissioner will receive:

a) a three year Treasury Strategy report, including the annual Investment Strategy, before the commencement of each financial year;
b) a mid year report on borrowing and investment activity, and
c) an annual report on borrowing and investment activity by 30 September of each year.

Appendix 2

Treasury Strategy 2013/14 to 2015/16

1. Introduction

1.1 The revised Treasury Management Code of Practice (the Code) has emphasised a number of key areas including the following:

a) The Code must be formally adopted;
b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Commissioner's treasury management activities.
c) The Commissioner's appetite for risk, including the appetite for any use of financial instruments in the prudent management of those risks, must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out;
d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.
e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support.
f) A sound diversification policy with high credit quality counterparties which considers setting country, sector and group limits.
g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.
h) The main annual treasury management reports must be approved by the Commissioner.
i) There needs to be a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
j) Each Commissioner must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
k) Treasury management performance and policy setting should be subjected to prior scrutiny.
l) Commissioner's and Committee members dealing with treasury management activities should be provided with access to relevant training as those charged with governance are also personally responsible for ensuring they have the necessary skills and training.
m) Responsibility for these activities must be clearly defined within the organisation.
n) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Commissioner.

1.2 This Strategy has been prepared in accordance with the Code.

1.3 The Commissioner will adopt the following reporting arrangements in accordance with the requirements of the revised Code:

Area of Responsibility	Commissioner/ Committee/ Officer	Frequency
Treasury Management Policy & Strategy / Annual Investment Strategy	Commissioner with review delegated to Audit Committee.	Annually before the start of the year
Annual Report	Commissioner with review delegated to Audit Committee.	Annually by 30 September after the end of the year
Scrutiny of treasury management performance via mid year report	Commissioner with review delegated to Audit Committee.	Mid Year
Scrutiny of treasury management strategy, policies and procedures	Audit Committee	Annually before the start of the year
Treasury Management Monitoring Reports	Treasurer	Monthly/Weekly
Treasury Management Practices	Treasurer	Monthly

1.4 The revised Treasury Management Code covers the following Prudential Indicators which were approved by Commissioner on the 27th February 2013:

- Authorised limit for external debt
- Operational boundary for external debt
- Actual external debt
- Upper limits on fixed and variable rate exposure
- Upper and lower limits to the maturity structure of borrowing
- Upper limits to the total principal sums invested longer than 364 days.

1.5 In addition to the above indicators, where there is a significant difference between the net and the gross borrowing position the risk and benefits associated with this strategy will be clearly stated in the annual strategy.

1.6 The strategy covers:

a) Prospects for interest rates;
b) Treasury limits in force which will limit the treasury risk and activities of the Commissioner, including prudential and treasury indicators;
c) The borrowing strategy;
d) Sensitivity forecast;
e) External and internal borrowing;
f) Debt rescheduling;
g) Policy on borrowing in advance of need;
h) The investment strategy; and
i) The policy on the use of external service providers.

2. Prospects for Interest Rates

2.1 The table shown below outlines the Commissioner's view of anticipated movements in interest rates, based on guidance received from the Commissioner's treasury management advisers Sector Treasury Services, and various brokers.

	March 2013	June 2013	Sept 2013	Dec 2013	March 2014	March 2015	March 2016
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.75%
5 yr PWLB*	1.50%	1.50%	1.60%	1.60%	1.70%	2.20%	2.90%
10 yr PWLB	2.50%	2.50%	2.60%	2.60%	2.70%	3.20%	3.90%
25 yr PWLB	3.80%	3.80%	3.80%	3.80%	3.90%	4.30%	5.00%
50 yr PWLB	3.90%	4.00%	4.00%	4.00%	4.10%	4.50%	5.20%

* Public Works Loan Board, a statutory body operating within the UK Debt Management Office, which is an executive agency of HM Treasury. The PWLB's function is to lend money to other prescribed public bodies.

Short Term Interest Rates

2.2 Growth in the UK is expected to be weak over the next two years and as there is also a risk of a return to recession it is not expected that the base rate will increase from 0.50% until 2014 at the earliest.

Long Term Interest Rates

2.3 Following advice from Sector treasury management advisers, the Commissioner's view on longer term fixed interest rates is that there will be little difference between 25 year and 50 year rates which are expected to remain around 4% throughout 2013/14. It is also expected that PWLB rates on loans less than ten years in duration will be lower than longer term loans.

3. Treasury Limits for 2013/14 to 2015/16 including Prudential Indicators

3.1 It is a statutory requirement of the Local Government Finance Act 1992, for the Commissioner to produce a balanced budget. In particular, Section 31(a), as amended by the Localism Act 2011, requires the Commissioner to calculate the budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from increases in interest charges and increases in running costs from new capital projects are limited to a level, which is affordable within the projected income of the Commissioner for the foreseeable future.

3.2 It is a statutory duty under Section 3 of Part 1 of the Local Government Act 2003**,** and supporting regulations, for the Commissioner to determine and keep under review how much it can afford to borrow. The amount so determined is termed the Affordable Borrowing Limit. The Authorised Limit represents the legislative limit specified in the Act.

3.3 The Prudential Code for Capital Finance in Local Authorities is a professional code that sets out a framework for self-regulation of capital spending, in effect allowing Commissioners to invest in capital projects without any limit as long as they are affordable, prudent and sustainable.

3.4 The Commissioner must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires the Commissioner to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and housing rent levels is affordable.

3.5 To facilitate the decision making process and support capital investment decisions the Prudential Code and the Treasury Management Code requires the Commissioner to agree and monitor a minimum number of prudential indicators which were approved by the Commissioner on 27th February 2013 as attached at Appendix 4.

3.6 The Treasurer will ensure systems are in place to monitor the treasury limits and will report to the Commissioner instances where limits are breached, with the exception of short-term breaches of the Operational Boundary. The Operational Boundary is set so that if breached it acts as an early warning of the potential to exceed the higher Authorised Limit and as such temporary breaches due to debt restructuring and temporary borrowing are acceptable, providing they are not sustained.

4. Borrowing Strategy

4.1 The Local Government Act 2003 does not prescribe approved sources of finance, only that borrowing may not, without the consent of HM Treasury, be in other than Sterling.

4.2 The two main options available for the borrowing strategy for 2013/14 are PWLB loans and market loans. The interest rate applicable to either PWLB or markets loans can be fixed or variable.

4.3 Variable rate short term borrowing is expected to be cheaper than long term fixed borrowing and therefore may be considered throughout the financial year. Due to the expectation that interest rates will rise, the risk of the potential increase in interest rates will be balanced against any potential short term savings.

4.4 There are different type of market loans available, including variable and fixed interest rate loans and Lender Option/Borrower Option (LOBO) loans. A LOBO is a loan where the lender can exercise their right to increase the interest rate of the loan at each call date. The borrower can then choose to either accept the higher interest rate or repay the loan. These loans are usually offered at an interest rate lower than the corresponding PWLB loan rate but this option increases the risk that it may be necessary to replace a loan at a time when the interest rates are high.

4.5 To mitigate this risk a limit is placed on the total level of borrowing that can be taken as variable interest rate loans. To provide scope to utilise new market products should they become available as well as minimise the cost of borrowing and increase the diversification of the debt portfolio it is proposed that the limit on variable rate loans should be 40% of total borrowing 2013/14.

4.6 The main strategy is therefore:

- When 25 year PWLB rates fall back to or below 4.10% borrowing should be considered, with preference given to terms of less than 20 years to enhance the diversity of the borrowing portfolio.
- Consideration will be given to borrowing market loans which are at least 20 basis points below the PWLB target rate.

Sensitivity of the forecast

4.7 The Commissioner, in conjunction with Sector, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to any changes. The main sensitivities of the forecast are likely to be the two scenarios below:

- If it were felt that there was a significant risk of a sharp rise in interest rates, 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 pursued whilst interest rates were still relatively low.
- If it were felt that there was a significant risk of a sharp fall in interest rates, due to e.g. a marked increase of risks of recession, then long term borrowings will be postponed.

4.8 Against this background, caution will be adopted in the management of the 2013/14 treasury operations. The Treasurer will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances having delegated powers to invest and manage the funds and monies of the Commissioner.

External and Internal Borrowing

4.9 As at 12th March 2013 the Commissioner has net debt of £57.909m; this means that borrowing is currently higher than investments with total borrowing of £75.133m and investments of £17.224m.

4.10 Investment interest rates are expected to be below long term borrowing rates throughout 2013/14 therefore value for money considerations indicate that best value can be obtained by delaying new external borrowing and by using internal cash balances to finance new capital expenditure in the short term (this is referred to as internal borrowing). Any short term savings gained from adopting this approach will be weighed against the potential for incurring additional long term costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be higher.

4.11 The Treasurer has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. The significant difference between early redemption rates and interest rates payable on PWLB debt means that large premiums are likely to be incurred by such action. This situation will be monitored in case the differential is narrowed by the PWLB.

Borrowing in advance of need

4.12 The Commissioner 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 that it is in line with the projected capital financing requirement and prudential indicators and that the Commissioner can demonstrate value for money and ensure the security of the funds.

4.13 In determining whether borrowing will be undertaken in advance of need the Treasurer 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; and
- consider the alternative forms of funding.

5. Debt Rescheduling

5.1 Any rescheduling opportunities will be considered in line with procedures approved under the Treasury Management Practice Statements and will include a full cost/benefit analysis of any proposed variations. Any positions taken via rescheduling will be in accordance with the strategy position outlined in Section 4 above and will also take into account the prudential and treasury limits.

5.2 The reasons for any proposed rescheduling will include:
- the generation of cash savings at minimum risk; and
- in order to amend the maturity profile and/or the balance of volatility in the Commissioner's borrowing portfolio.

5.3 The Treasurer in line with delegated powers outlined in the approved Treasury Management Practice Statement, will approve all rescheduling.

5.4 As short term borrowing rates are expected to be cheaper than longer term rates, there may be opportunities to generate savings by switching from long term debt to short term debt. Opportunities identified will take into consideration the likely cost of refinancing these short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

5.5 Consideration will also be given to the potential for making savings by running down investment balances by repaying debt prematurely as short term rates on investments are likely to be lower than rates paid on currently held debt. However, this will need careful consideration in the light of premiums that may be incurred by such a course of action and other financial considerations.

All rescheduling will be reported to Commissioner in the mid year and annual reports.

6. Investment Strategy 2013/14 to 2015/16

Introduction

6.1 The Commissioner has regard to the CLG's Guidance on Local Government Investments and CIPFA's Code of Practice. The Commissioner must produce a strategy on an annual basis which covers the subsequent three year period.

6.2 This annual strategy states which investments the Commissioner may use for the prudent management of its treasury balances during the financial year under the categories of **specified investments** and **non-specified investments.**

6.3 Specified investments are denominated in sterling, are for periods of 364 days or less and do not involve the acquisition of share or loan capital in any body corporate. Such an investment will be with either:

- the UK Government or a local authority, parish or community council, or
- a body or investment scheme which has been awarded a high credit rating by a credit rating agency.

6.4 Non-specified investments are deemed more risky and guidance on local government investments requires more detailed procedures. Such procedures are required in order to regulate prudent use and establish maximum amounts which may be invested in each category.

6.5 Both specified and non-specified investment types currently utilised by the Commissioner are detailed in Appendix 6, along with approved limits. In addition to these numerous other investment options are available for use and these may be considered suitable for use in the future. Should this be the case then the option will be evaluated in line with the procedures contained within the approved Treasury Management Practice Statement.

Investment Objectives

6.6 All investments will be in Sterling.

6.7 The Commissioner's primary investment objective is the security of the capital investment. The Commissioner will also manage the investments to meet cash flow demands and to achieve a reasonable return commensurate with the proper levels of security and liquidity. The risk appetite of the Commissioner is low in order to give priority to security of its investments.

6.8 The borrowing of monies purely to invest is unlawful and the Commissioner will not engage in such activity.

Creditworthiness Policy

6.9 The creditworthiness service provided by Sector Treasury Services are used to asses the creditworthiness of counterparties. The service provided by Sector uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following information as overlays which are combined in a weighted scoring system:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap spreads, financial agreements that compensate the buyer in the event of a default, which give an early warning of likely changes in credit ratings; and
- Sovereign ratings to select counterparties from only the most creditworthy countries.

6.10 The end product of this modelling system is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Commissioner to determine the duration for investments and are therefore referred to as durational bands. The Commissioner is satisfied that this service gives the required level of security for its investments. It is also a service which the Commissioner would not be able to replicate using in-house resources.

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

6.12 The Commissioner has also determined the minimum long-term, short-term and other credit ratings it deems to be “high” for each category of investment. These “high” ratings allow investments of 364 days or less to be classified as **specified investments**. The Commissioner’s approved limits for this “high” credit rating for deposit takers are as follows:

High Rated	Fitch	Moody’s	Standard & Poor’s
Short term (ability to repay short term debt)	F1	P1	A1
Long term(ability to repay long term debt)	AA-	Aa3	AA-
Individual(ability to stand alone)	B	B(-)	n/a
Support(likelihood of external support)	3	n/a	n/a

6.13 To ensure consistency in monitoring credit ratings throughout 2013/14 the Commissioner will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties, as the credit rating agency issuing the lowest rating could change throughout the year as agencies review the ratings that they have applied to countries, financial institutions and financial products. The ratings of all three agencies will be considered, with Fitch being used as a basis for inclusion on the lending list. In addition to this the Sector creditworthiness service will be used to determine the duration that deposits can be placed for. This service uses the ratings from all three agencies, but by using a scoring system, does not give undue consideration to just one agency’s ratings.

6.14 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector’s weekly credit list of worldwide potential counterparties. The maximum maturity periods and amounts to be placed in different types of investment instruments are detailed in Appendix 6.

6.15 UK Government nationalised/part nationalised banks will have a maximum limit of 25% or £20m of total investment, all other counterparties will not exceed a maximum limit equal to 20% of total investments or £20m. Unless there are major changes in the level of investment balances throughout the year this limit will be reviewed prior to the commencement of each financial year.

6.16 Where more than one counterparty from a group is included on the counterparty list the group in total will be controlled by the above limits with the maximum limit being that of the parent company. Within the group each counterparty/subsidiary will have individual limits based on their creditworthiness although the total placed with the subsidiaries will not exceed the limit of the parent company. Subsidiaries that do not satisfy the minimum credit criteria will not be included.

6.17 A number of counterparties are also approved by the Treasurer for direct dealing. These counterparties are included on the approved list and dealing will be within agreed limits. Direct dealing with individual counterparties must be approved by the Treasurer prior to investments being placed.

Nationalised/Part Nationalised Banks

6.18 A number of banks in the UK do not conform to the credit criteria usually used to identify banks that are of high credit worthiness. In particular, as they are no longer separate institutions in their own right it is impossible for an individual rating to be assigned to them. Due to Government ownership these institutions now have the highest short-term rating possible as they effectively take on the creditworthiness of the Government and deposits placed with them are effectively with the Government. Taking this into consideration they have the highest rating possible. As a result of this when deposits are being considered with these counter parties the limits will be in accordance with the Sector creditworthiness list.

6.19 Where the bank has not been fully nationalised but receives substantial support from the UK Government (greater then 40% ownership) the individual rating of the bank will not be taken into consideration and the relevant banks will be included on the Council's lending list as prescribed by the Sector creditworthiness list as detailed in 6.18.

Supported Banks

6.20 The UK Government has not given a blanket guarantee on all deposits but has underlined its determination to ensure the security of the UK banking system with a £500bn support package to banks that are willing to accept the terms of the Credit Guarantee Scheme. This package will be available to banks and building societies until 2014. Banks and building societies covered by the scheme will be included on the Commissioner's lending list up to the maximum limit prescribed by the Sector credit criteria matrix and limited to 364 days or less.

Foreign Banks

6.21 A number of countries have supported their banking system by giving a blanket guarantee on all deposits. Each of these guarantees will be assessed individually taking into consideration the Sovereign rating of the country concerned and the credit rating of the banks concerned. Only banks domiciled in countries with a minimum sovereign rating of AA+ will be considered for inclusion on the approved list, they must also meet the high rated lending criteria and have operations based in London. Limits will be prescribed by the sector creditworthiness list and limited to 364 days or less. Each country will be limited to the maximum investment limit of £20m or 20% of the Commissioner's total investments.

Local Authorities

6.22 The Commissioner invests with other Local Authorities on an ad hoc basis, each investment is considered on an individual basis and agreed by the Treasurer, prior to funds being placed. Limits are detailed at Appendix 6.

Non-specified Investments

6.23 In addition to the above specified investments, the Commissioner has also fully considered the increased risk of **non-specified investments** and has set appropriate limits for non-high rated deposit takers. These are as follows:

Non High Rated	Fitch	Moody’s	Standard & Poor’s
Short term	F1	P1	A1
Long term	A-	A3	A-
Individual*	C	C	n/a
Support	3	n/a	n/a

Limits for non-high rated counterparties and non-rated building societies are detailed at Appendix 6.

6.24 The credit ratings will be monitoring as follows:

- All credit ratings are reviewed weekly. The Commissioner has access to Fitch, Moody’s and Standard and Poor’s credit ratings and is alerted to changes through its use of the Sector creditworthiness service. Ongoing monitoring of ratings also takes place in response to ad-hoc e-mail alerts from Sector.
- If a counterparty’s or deposit scheme’s rating is downgraded with the result that it no longer meets the Commissioner’s minimum criteria, the further use of that counterparty/deposit scheme as a new deposit will be withdrawn immediately.
- If a counterparty is upgraded so that it fulfils the Commissioner’s criteria, its inclusion will be considered for approval by the Treasurer.

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

Investment balances / Liquidity of investments

6.26 The Commissioner deposits funds beyond 364 days to a maximum of three years. This will continue where the counterparty is deemed to be a low credit risk to ensure a good rate of return is maintained in the current market conditions. Deposits beyond 364 days will only be considered when there is minimal risk involved. With deposits of this nature there is an increased risk in terms of liquidity and interest rate fluctuations. To mitigate these risks a limit of £15m (20% of total investments) has been set and a prudential indicator has been calculated (See Appendix 4). Such sums will only be placed with counterparties who have the highest available credit rating or other local authorities.

6.27 Deposits for periods longer than 364 days are classed as **non-specified investments** and this will increase the total limit of overall deposits in this classification to 75%.

Investments defined as capital expenditure

6.28 The acquisition of share capital or loan 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’**.

6.29 A loan or grant by the Commissioner to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by the Commissioner. It is therefore important for the Commissioner to clearly identify if the loan was made for policy reasons (e.g. to a registered social landlord for the construction/improvement of dwellings) or if it is an investment for treasury management purposes. The latter will be governed by the framework set by the Commissioner for ‘specified’ and ‘non-specified’ investments.

Internal Investment Strategy

6.30 The Treasurer will monitor the interest rate market and react appropriately to any changing circumstances.

6.31 The Commissioner takes the view that base rate will remain at 0.50% throughout 2013/14 so short term deposits, up to 364 days, will be utilised to cover cash flow and minimise risk to the Commissioner. The Commissioner will avoid locking into longer term deals while investment rates are down at historically low levels. Long term deposits, beyond 364 days, will only be used where minimal risk is involved and the counterparties are considered to be supported by the UK Government.

End of year investment report

6.32 By the end of September each year the PCC will receive a report from Joint Audit Committee on its investment activity as part of its annual treasury report.

Policy on use of external service providers

6.33 The Commissioner uses Sector Treasury Services as its external treasury management advisers.

6.34 The Commissioner 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.

6.35 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 Commissioner 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.

Scheme of Delegation

6.36 As required by the Guidance Notes for Local Authorities the Treasury Management Scheme of Delegation is detailed below.

Commissioner

- Set and approve treasury management policy and strategy prior to the start of each financial year;
- Approve prudential and treasury indicators and any subsequent amendments if required;
- Agree and approve annual treasury management budgets;
- Approve any proposed variations in treasury strategy or policy;
- Agree annual report;
- Monitor Prudential and Treasury Indicators; and
- Receive and review monitoring reports including the annual report and act on recommendations.

Audit Committee

- Scrutinise the treasury management strategy, policies and practices and make recommendations to the Commissioner;
- Receive and review monitoring reports including the annual report; and
- Agree mid year monitoring report.

Role of the Section 151 Officer

As required by the Guidance Notes for Local Authorities the role of the Section 151 Officer in relation to treasury management is detailed below.

- Recommending the Code of Practice to be applied, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- Submitting regular treasury management policy reports;
- Submitting budgets and budget variations;
- Receiving and reviewing management information reports;
- Reviewing the performance of the treasury management function;
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- Ensuring the adequacy of internal audit, and liaising with external audit; and
- Recommending the appointment of external service providers.

7. Other Issues

Heritable Bank Deposits

7.1 When Heritable bank entered administration in October 2008 the former Police Authority had £5.2m invested which was due to mature with interest by the end of 2008/09. The administrator is still running the business off and dividends are now being paid every six months.

7.2 To date dividends totalling £4.096m (77.28p in the £) have been received, with the next dividend due in July 2013. The prospects for a full recovery are still good with the latest forecast from the administrators of at least a 90% return.

Appendix 3

Prudential Indicators –Treasury Management

Authorised Limit For External Debt			
	2013/14 £000	**2014/15 £000**	**2015/16 £000**
Borrowing	170,000	170,000	170,000
Other Long term Liabilities	0	0	0
Total	**170,000**	**170,000**	**170,000**

Operational Boundary For External Debt			
	2013/14 £000	**2014/15 £000**	**2015/16 £000**
Borrowing	145,000	145,000	145,000
Other Long term Liabilities	0	0	0
Total	**145,000**	**145,000**	**145,000**

Treasury Indicators

Upper Limit on Fixed and Variable Interest Rates Exposures

Range	2013/14 £000	2014/15 £000	2015/16 £000
Fixed Rate:			
Upper	85,206	87,035	84,033
Lower	(20,617)	(51,581)	(56,413)
Variable Rate:			
Upper	12,750	13,250	13,250
Lower	(20,000)	(20,000)	(20,000)

Upper and Lower Limits for the Maturity Structure of Borrowings

	Upper Limit	Lower Limit
Under 12 months	20%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	70%	0%
10 years and above	90%	0%

Upper Limit on Amounts Invested Beyond 364 Days			
	2013/14 £000	**2014/15 £000**	**2015/16 £000**
Investments	15,000	15,000	15,000

Appendix 4

Specified Investments (All Sterling Denominated)

Investment type	Share/ Loan Capital	Repayable/ Redeemable within 12 months	Security / Minimum Credit Rating	Capital Expenditure	Circumstance of use	Maximum period
Term deposits with the UK Government or with English local authorities (i.e. local authorities as defined under Section 23 of the 2003 Act) with maturities up to 364 days.	No	Yes	High security although LA's not credit rated. *See section 6.3*	No	In-house	364 days
Term deposits with credit-rated deposit takers (banks and building societies), including callable deposits with maturities up to 364 days.	No	Yes	Secure Varied minimum credit rating *See section 6.3*	No	In-house	364 days
Money Market Funds (including 7 day notice account) These funds are instant access and therefore do not have a maturity date.	No	Yes	Secure Varied minimum credit rating *See section 6.3*	No	In-house	The investment period is subject to liquidity and cash flow requirements. It is assumed that funds are placed overnight and will be returned and reinvested the next working day (although no actual movement of cash may take place).

Non-Specified Investments (All Sterling Denominated)

Investment type	(A) Why use it (B) Associated risks	Share/ Loan Capital	Repayable/ Redeemable within 12 months	Security / Minimum credit rating	Capital Expenditure	Circumstance of use	Max % of overall investments	Maximum maturity of investment
Rated deposit takers (banks and building societies) which do not meet the Commissioner's "high" credit rating	(A) To improve ability to place smaller amounts (B) Greater risk than "high" credit rating counterparties but advance warning by rating agency of potential problems. The Commissioner has fully considered this investment category and set appropriate investment and maturity limits in order to minimise risk	No	Yes	Secure Varied minimum Credit rating *Minimum: Long term A-* *Short term F1* *Indiv. C* *Support 3*	No	In-house	55%	6 months (but set on an individual counterparty basis)
Term deposits with UK Government, English Local Authorities or credit rated banks and building societies, with maturities over 1 year	A) To improve the ability to "lock in" at times of high interest rates to secure a higher return over a longer period should rates be forecast to fall. B) Lower liquidity and greater risk of adverse interest rate fluctuations. The Commissioner has fully considered this investment category and set appropriate investment and maturity limits in order to minimise risk.	No	No	Secure Varied minimum credit rating	No	In-house	20%	3 years

Appendix 5

Maximum Maturity Periods and Amounts

Organisation	Criteria	Max Amount*	Max Period
High Rated (Specified Investments – High rated and up to 364 days see Appendix E)	Minimum F1, A1 or P1 short term backed up by minimum AA-, AA3 or AA- long term credit rating and support ratings of 1. Minimum F1, A1 or P1 short term backed up by minimum AA-, AA3 or AA- long term credit rating and support ratings of 2. Minimum F1, A1 or P1 short term backed up by minimum AA-, AA3 or AA- long term credit rating and support ratings of 3.	£20m £7.5m £6m	3 years 364 days 6 months
Non-High Rated	Minimum F1, A1 or P1 short term backed up by minimum A-, A3 or A- long term credit rating and support ratings of 1. Minimum F1, A1 or P1 short term backed up by minimum A-, A3 or A- long term credit rating and support ratings of 2. Minimum F1, A1 or P1 short term backed up by minimum A-, A3 or A- long term credit rating and support ratings of 3.	£5m £4m £3m	6 months 3 months 1 month
UK Local Authorities	Authorities must fall into the following categories: - Inner London Boroughs - Outer London Boroughs - Metropolitan Districts - County Councils - Unitary Authorities (England)	£10m	3 years
Money Market Funds	AAA long-term rating backed up with lowest volatility rating (MR1+) with assets >£1bn	£7.5m	overnight

* Restricted to a maximum of either 25% or 20% of total investments depending on the counterparty.