Report to:	**The Executive**		
Date:	**13th February 2012**		
Report of:	**Director of Corporate Resources**	**Report No:**	
Contact Officer:	**Martin C. Connor** **Policy Accountant (Tax and Treasury)**	**Tele No:**	**(01204) 331637**
Report Title:	**Treasury Management and Investment Strategies for 2012/13 to 2014/15**		

Non Confidential: **This report does not contain information which warrants its consideration in the absence of the press or members of the public.**

Purpose:

This report outlines the Council's prudential indicators for 2012/13 – 2014/15 and sets out the expected treasury operations for this period. It fulfils two key legislative requirements:

The **treasury management strategy statement** which sets out how the Council's treasury service will support the capital decisions taken on an earlier item, the day to day treasury management and the limitations on activity through **treasury prudential indicators**. The key indicator is the **Authorised Limit**, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003. This is in accordance with the CIPFA Code of Practice on Treasury Management; and

The **investment strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the CLG Investment Guidance.

Recommendations:

The Executive is asked to recommend to the Council for Approval:

The Treasury Management Strategy 2012/13 to 2014/15 and the treasury limits on activity contained within this report.

The Authorised Limit Prudential Indicator.

The Investment Strategy 2012/13 contained in the treasury management strategy.

Decision:

Background Docs:

Introduction

1. Revised editions of the CIPFA Prudential Code and CIPFA Treasury Management Code of Practice were produced in November 2011. The CLG issued revised guidance in relation to investments in March 2010. This report incorporates all of the changes arising from these Codes and guidance.
2. The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, and reflects the outcome of the Council’s underlying capital appraisal systems. This report updates currently approved indicators.
3. The treasury management service is an important part of the overall financial management of the Council’s affairs. An earlier item will have considered the affordability and impact of capital expenditure decisions, and set out the Council’s overall capital framework and the effective funding of these decisions.
4. This report sets out both the treasury management and investment strategies for 2012/13 to 2014/15 to complement the earlier item, and also includes the prudential indicators relating specifically to the treasury activity, which require approval. Together these two items form part of the process which ensures the Council meets the balanced budget requirement under the Local Government Finance Act 1992.
5. The Council’s treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised November 2011). This Council adopted the Code of Practice on Treasury Management on 15th October 2003, and the revised Code of Practice on 16th February 2010. This adoption is a requirement of one of the prudential indicators. The Treasury Management Policy Statement is appended at Annex 1; this has been updated from the statement that was approved on 14th February 2011 to reflect the revised Code of Practice issued in November 2011. The changes are highlighted in red text.
6. The Treasury Management Code of Practice requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming three years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year. Quarterly monitoring reports are presented to both the Executive Member for Health and Corporate Resources and to the Audit Committee; this is in excess of the requirement of the revised Code of Practice that there is a mid-year monitoring report.
7. This strategy covers:
   - The Council’s debt and investment projections;
   - The Council’s estimates and limits on future debt levels;
   - The expected movement in interest rates;
   - The Council’s borrowing and investment strategies;
   - Treasury performance indicators;
   - Specific limits on treasury activities; and
   - Any local treasury issues.

Debt and Investment Projections 2012/13 – 2014/15

8. The borrowing requirement comprises the expected movement in the Capital Financing Requirement (CFR) and any maturing debt which will need to be re-financed. The expected debt position at the end of each year represents the Operational Boundary prudential indicator.

	2011/12 Revised	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate

	£m	£m	£m	£m
External Debt				
Debt at 1 April	72.3	90.3	90.3	90.3
Expected change in debt	+18.0	-	-	-7.0
Debt at 31 March	90.3	90.3	90.3	83.3
The debt estimated at 31 March represents the Council's Operational Boundary				

On 11th June 2011 the Council took a loan of £18 million from the Royal Bank of Scotland at a fixed interest rate of 3%. No further borrowing is anticipated in the period 2011/12 to 2014/15. The only debt which reaches maturity in this period is a £7 million loan from Depfa Bank that matures on the 28th January 2015.

Limits to Borrowing Activity

9. Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.
10. For the first of these the Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2011/12 and the following three financial years. This allows some flexibility for limited early borrowing for future years.

	2011/12 Revised	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
	£m	£m	£m	£m
Gross Borrowing	90.3	90.3	90.3	83.3
Investments	60.0	30.0	30.0	23.0
Net Borrowing	30.3	60.3	60.3	60.3
CFR	252.0	253.2	246.9	240.3

11. The Director of Corporate Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.
12. The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.
13. The Council is asked to approve the following Authorised Limit:

Authorised Limit	2011/12 Revised	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
	£m	£m	£m	£m
Total	252.0	253.2	246.9	240.3

Expected Movement in Interest Rates

Medium-Term Rate Estimates (averages)

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	25 year	50 year
March 2012	0.50	0.70	1.50	2.30	4.20	4.30
June 2012	0.50	0.70	1.50	2.30	4.20	4.30
Sept 2012	0.50	0.70	1.50	2.30	4.30	4.40
Dec2012	0.50	0.70	1.60	2.40	4.30	4.40
March 2013	0.50	0.75	1.70	2.50	4.40	4.50
June 2013	0.50	0.80	1.80	2.60	4.50	4.60
Sept 2013	0.75	0.90	1.90	2.70	4.60	4.70
Dec 2013	1.00	1.20	2.20	2.80	4.70	4.80
March 2014	1.25	1.40	2.40	2.90	4.80	4.90
June 2014	1.50	1.60	2.60	3.10	4.90	5.00

14. Annex 4 includes the advice we have received from Sector Treasury Services, the Council's advisers. In summary this indicates that short term rates are expected to remain on hold for a considerable time. The danger of a double-dip recession is fading but the crisis in the euro-zone, the prospects of tight economic policies at home and tenuous consumer confidence means the threat has still not evaporated completely.

Borrowing Strategy 2012/13 - 2014/15

~~15.~~ The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will continue to take a cautious approach to its treasury strategy.

~~16.~~ Long-term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although more modestly. The Director of Corporate Resources, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that shorter term fixed rates may provide lower cost opportunities in the short/medium term.

~~17.~~ With the repayment of all of the Council's PWLB debt following the housing stock transfer in March 2011 the opportunities for debt rescheduling are limited. However with the likelihood of long term rates increasing over the period, the lenders of the Market Loans may exercise their option to increase rates which may provide the Council with an opportunity to exercise its option to repay these loans and switch to either fixed rate or cheaper shorter term debt.

~~18.~~ The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

Investment Strategy 2012/13 – 2014/15

19. **Key Objectives -** The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate cash flow second – the investment return being a third objective. Following the economic background above, the current investment climate has one over-riding risk consideration that of counterparty security risk. As a result of these underlying concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy.

20. **Risk Benchmarking** – A development in the revised Codes and the CLG guidance is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting, although the application of these is more subjective in nature. Additional background to the approach taken is attached at Annex 3.

21. These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Quarterly Monitoring Reports.

22. Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

    - 0.08% historic risk of default when compared to the whole portfolio.

23. Liquidity – In respect of this area the Council seeks to maintain:

    - Bank overdraft - £ 2 m.
    - Liquid short term deposits of at least £ 5 m available with a week's notice.
    - Weighted Average Life (this is the average life of the investments which takes into account the amount invested; therefore large investments have a greater impact on the weighted average life than small investments) benchmark during 2012/13 is expected to be between 0.25 and 0.5 years.

24. Yield - Local measures of yield benchmarks are:

    - Investments – Internal returns above the 7 day London Inter Bank Bid (LIBID) rate

25. **Investment Counterparty Selection Criteria -** The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

    - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.
    - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

26. The Director of Corporate Resources will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality the Council may use rather than defining what its investments are.

27. The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

28. Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from

the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

29. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- **Banks/Building Societies–** the Council will only use UK banks and building societies which have at least the following Fitch, Moody's and Standard and Poor's ratings (where rated):
  - Short Term – *F1/P1/A1*
  - Long Term – *A-/A3/A-*
  - Individual / Financial Strength – *C/C* (Fitch / Moody's only)
  - Support – *3* (Fitch only)
- In addition the Council will use those banks which are classed as *an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008;* with the necessary short and long term ratings required of the Banks/Building Societies above. These institutions have been subject to suitability checks before inclusion, and have access to HM Treasury liquidity if needed.
- The Council's own banker (Co-operative Bank) if this falls below the above criteria;
- **Money Market Funds** – *AAA;*
- **UK Government** (including gilts and the Governments's Debt Management Office); and
- **Local Authorities and Parish Councils**.

30. **Time and Monetary Limits Applying to Investments:** The time limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch	Moody's	Standard & Poor's	Money Limit	Time Limit
Upper Limit Category	F1+ / AA-	P-1 / Aa3	A-1+ / AA-	£6m	3yrs
Lower Limit Category	F1 / A-	P-1 / A3	A-1+ / A-	£4m	1yr
Other Institution Limits	-	-	-	£10m	1 yr
Eligible Institution*	F1 / A-	P-1 / A3	A-1+ / A-	£4m	1 yr
Council's Bank **	-	-	-	£4m	1yr

* The Money Limit for the Royal Bank of Scotland, Bank of Scotland, National Westminster and Lloyds TSB was set at £10m in January 2012.

** If the Council's bank falls outside the other criteria, which the Co-operative Bank does, then the Council will apply the Lower Limit Category Limits.

(The Upper and Lower Limit categories will include banks and building societies. The Other Institution Limit will be for other local authorities, the DMADF, Money Market Funds. These are all considered high quality names – although not always rated – and therefore will likely have the same limit as the Upper Category.)

31. In the normal course of the council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments. Specified investments are for less than one year and Non –specified are for more than one year.

32. The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's security and liquidity requirements are safeguarded. This will also be limited by the investment prudential indicator below.

33. A list of counterparties which met the criteria outlined above is attached at Annex 2. This list was created as at 1 January 2012. As and when ratings change during the year, so the composition of the list will alter. However, only counterparties who meet the criteria above will ever be included and considered for investment. The credit rating of counterparties will be monitored regularly. The Council receives credit rating information from Sector Treasury Services on a daily basis, as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Corporate Resources, and if required new counterparties which meet the criteria will be added to the list.

34. **Use of additional information other than credit ratings** – Additional requirements under the Code of Practice now 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, equity prices etc) will be considered to compare the relative security of differing investment counterparties.

35. **Economic Investment Considerations -** Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in mid/late-2013. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

36. There is an operational difficulty arising from the current banking crisis. There is currently little value investing longer term unless credit quality is reduced. Whilst some selective options do provide additional yield uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.

37. Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF is part of the UK Debt Management Office, which is an executive agency of HM Treasury, and accepts local authority deposits), Money Market Funds, guaranteed deposit facilities and strongly rated institutions offered support by the UK Government. The credit criteria have been amended to reflect these facilities.

Sensitivity to Interest Rate Movements

38. Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

	2012/13 Estimate +1%	**2012/13 Estimate -1%**
	£000	**£000**
Revenue Budgets		

Interest on Borrowing	+525	-525
Related HRA Charge	-	-
Net General fund Borrowing	+525	-525
Investment Income	-300	+300

39. However this would be unlikely to occur as some of the interest rates are so high that a 1% increase in the underlying interest rates is only likely to trigger an increase of £200k in the interest paid on borrowing. The saving identified as a result of a reduction in interest rates in the table above will not be achieved as the Lenders are extremely unlikely to exercise an option whereby they reduce the interest rate charged. A more realistic assessment of the impact of an increase and decrease of 1% in the interest rate is shown in the table below.

	2012/13 Estimate +1%	**2012/13 Estimate -1%**
	£000	**£000**
Revenue Budgets		
Interest on Borrowing	+200	-
Related HRA Charge	-	-
Net General fund Borrowing	+200	-
Investment Income	-300	+300

Treasury Management Limits on Activity

40. There are four treasury activity limits, which were previously prudential indicators. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs. The indicators are:

- The amount of net debt as a percentage of gross debt.
- Upper limits on variable interest rate exposure – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.
- Maturity structures of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.
- Total principal funds invested for greater than 364 days – These limits are set to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

41. The Council is asked to approve the following prudential indicators:

	2011/12 Revised	**2012/13 Estimate**	**2013/14 Estimate**	**2014/15 Estimate**
Net debt as a % of Gross Debt	**%**	**%**	**%**	**%**
Upper Limit **NEW**	n/a	90	90	90
Lower Limit **NEW**	n/a	-50	-50	-50

Interest rate Exposures	%	%	%	%
Upper Limit on fixed interest rates based on debt	96	96	96	96
Upper Limit on variable interest rates based on debt	90	60	80	80
Maximum principal sums invested > 364 days	**£m**	**£m**	**£m**	**£m**
Principal sums invested > 364 days	15	15	15	15

Maturity Structure of fixed interest rate borrowing 2012/13		
	Lower	**Upper**
Under 12 months	0%	80%
12 months to 2 years	0%	80%
2 years to 5 years	0%	80%
5 years to 10 years	0%	80%
10 years to 20 years	0%	80%
20 years to 30 years	0%	80%
30 years to40 years	0%	80%
40 years to 50 years	0%	80%
50 years and above	0%	80%

Treasury Management Advisers

42. The Council uses Sector Treasury Services as its treasury management consultants. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings from the three main rating agencies and relevant market information to further assess potential counterparties;

43. Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review.

44. The present contract with Sector Treasury Services ends in November 2013.

Member and Officer Training

45. The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council has addressed this important issue by:

- Providing training by the Council's Treasury Management Advisers, Butlers on 17th September 2009 to Audit Committee, and
- Officers attending Treasury Management seminars and forums.

Local Issues

46. No further borrowing is currently anticipated in the period from 2011/12 to 2014/15.

47. In the event of a Lender exercising their option to increase the interest rate on their Market Loans the Council will review the options available with the Treasury Management Advisor, Sector

Treasury Services and may exercise the Borrower option to repay following an assessment of the prevailing interest rates at that time.

Annex 1

Treasury Management

INTRODUCTION

In 2011 CIPFA issued Codes of Practice on Treasury Management in The Public Services. These were due to increased attention being given to cash management and the Institute felt there was a need for expertise and caution in money market transactions.

As Bolton Council has always adopted a prudent approach to Treasury Management and has worked within the framework of CIPFA recommendations, the new Code of Practice has now been adopted.

As recommended by CIPFA, this document includes a Treasury Policy Statement and Treasury Management Practices (TMPs). The Schedules to the TMPs, various control systems and documentation that relate to Treasury Management in this Authority are held by the Tax and Treasury Team within the Corporate Resources Department.

CODE OF PRACTICE FOR TREASURY MANAGEMENT IN LOCAL AUTHORITIES

The Code of Practice for Treasury Management in Public Services issued by CIPFA in 2011 sets out a Policy and 12 Treasury Management Practices which Local Authorities are urged to formally adopt.

The Code recommended the formal adoption of the following clauses;

The Council previously adopted on 16th February 2010 the 3 key principles of CIPFA's "Treasury Management in the Public Services: Code of Practice" (the Code) as described in Section 4 of that Code. The changes are highlighted in red text.

(a) The Council should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management of its Treasury Management activities.

(b) Policies and practices should make it clear that the effective management and control of risk are prime objectives of the Treasury Management activities. The Council's appetite for risk forms part of the annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.

(c) The Council should acknowledge that the pursuit of best value in Treasury Management and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives and that within the context of effective risk management, their Treasury Management policies and practices should reflect this.

Accordingly, the Council will create and maintain, as the cornerstones for effective Treasury Management:

(a) A Treasury Management Policy Statement (Appendix A) stating the policies and objectives of its Treasury Management activities.

(b) Suitable Treasury Management Practices (Appendix B), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The Council will receive Quarterly Monitoring Reports on its Treasury Management Policies, practices and activities, including, as a minimum, an annual Strategy Plan in advance of the year and an annual report after its close, in the form described in its Treasury Management Procedures.

The Council delegates responsibility for the implementation and monitoring of its Treasury Management Polices and Practices to the Executive Member for Health and Corporate Resources and the execution and administration of Treasury Management decisions to the Director of Corporate Resources, who will act in accordance with the organisation's Policy Statement and Treasury Management Practices and being a CIPFA member, CIPFA's Standard Professional Practice on Treasury Management.

This Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

TREASURY MANAGEMENT POLICY STATEMENT

The Council defines its Treasury Management activities as:

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

This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

This organisation acknowledges that effective Treasury Management will provide support towards the achievement of its business and services objectives. It is therefore committed to the principles of achieving value for money in Treasury Management, and to employing suitable performance measurement techniques, within the context of effective risk management.

TREASURY MANAGEMENT PRACTICES

TMP 1 – Risk Management

General Statement

The Director of Corporate Resources will design, implement and monitor all arrangements for the identification, management and control of Treasury Management risk, will report at least annually on the adequacy/suitability thereof and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 *Reporting requirements and management information arrangements*. In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

(1) Credit and Counterparty Risk Management

Bolton Council regards a key objective of its Treasury Management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 *Approved instruments, methods and techniques* and listed in the schedule to this document. It also recognises the need to have and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing arrangements.

(2) Liquidity Risk Management

Bolton Council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.

This organisation will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

(3) Interest Rate Risk Management

Bolton Council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 *Reporting requirements and management information arrangements.*

It will achieve these objectives by the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. The above are subject at all times to the consideration and, if required, approval of any policy or budgetary implications.

It will ensure that any hedging tools used such as derivatives are only used for the management of the risk and the prudent management of financial affairs and that the policy for the use of derivatives is clearly detailed in the annual strategy.

(4) Exchange Rate Risk Management

It will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

(5) Refinancing Risk Management

Bolton Council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective and will avoid over-reliance on any one source of funding if this might jeopardise achievement of the above.

(6) Legal and Regulatory Risk Management

Bolton Council will ensure that all its Treasury Management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1(1) *credit and counterparty risk management*, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

Bolton Council recognises that future legislative or regulatory changes may impact on its Treasury Management activities and so far as is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the Council.

(7) Fraud, Error and Corruption and Contingency Management

Bolton Council will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its Treasury Management dealings. Accordingly, it will employ suitable systems and procedures and will maintain effective contingency management arrangements to these ends.

(8) Market Risk Management

Bolton Council will seek to ensure that its stated Treasury Management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests and will accordingly seek to protect itself from the effects of such fluctuations.

TMP 2 - PERFORMANCE MEASUREMENT

Bolton Council is committed to the pursuit of value for money in its Treasury Management activities and to the use of performance methodology in support of that aim within the framework set out in its Treasury Management Policy Statement.

Accordingly, the Treasury Management function will be the subject of ongoing analysis of the value it adds in support of Bolton Council's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements. The performance of the Treasury Management function will be measured using the criteria set out in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

TMP 3 - DECISION-MAKING AND ANALYSIS

Bolton Council will maintain full records of its Treasury Management decisions and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time. The issues to be addressed and processes and practices to be pursued in reaching decisions are detailed in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

This Treasury Management Practice is reinforced by the Dealing Procedures set out in TMP5.

TMP 4 - APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

Bolton Council will undertake its Treasury Management activities by employing only those instruments, methods and techniques detailed in the schedule to this document and within the limits and parameters defined in TMP1 *Risk Management*.

Where Bolton Council intends to use derivative instruments for the management of risk, these will be limited to those set out in its annual Treasury Strategy. The organisation will seek proper advice and will consider that advice when entering into arrangements to use such products to ensure that it fully understands those products.

TMP 5 - ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES AND DEALING ARRANGEMENTS

Bolton Council considers it essential for the purposes of the effective control and monitoring of its Treasury Management activities, for the reduction of the risk of fraud or error and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner and that there is at all times a clarity of Treasury Management responsibilities.

The principle on which this will be based is a clear distinction between those charged with setting Treasury Management Policies and those charged with implementing and controlling these Policies, particularly with regard to the execution and transmission of funds, the recording and administering of Treasury Management decisions and the audit and review of the Treasury Management function.

If and when the Council intends, as a result of lack of resources or other circumstances, to depart from these principles, the Director of Corporate Resources will ensure that the reasons are properly reported in accordance with TMP6 *Reporting requirements and management information arrangements* and the implications properly considered and evaluated.

The responsible officer will ensure that there are clear written statements of the responsibilities for each post engaged in Treasury Management and the arrangements for absence cover. The present arrangements are detailed in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

The responsible officer will ensure there is proper documentation for all deals and transactions and that procedures exist for the effective transmission of funds. The present arrangements are detailed in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

The delegations to the responsible officer in respect of Treasury Management are set out in the Schedule to this document. The responsible officer will fulfil all such responsibilities in accordance with the organisation's Policy Statement and TMPs and if a CIPFA member, the *Standard of Professional Practice on Treasury Management*

TMP 6 - REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS

Bolton Council will ensure that regular reports are prepared and considered on the implementation of its Treasury Management Policies, on the effects of decisions taken and transactions executed in pursuit of those policies, on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its Treasury Management activities and on the performance of the Treasury management function.

As a minimum, the Executive will receive:-

- An Annual Report on the Strategy and Plan to be pursued in the coming year.
- A mid -year review
- An Annual Report on the performance of the Treasury Management function, on the effects of the decisions taken and the transactions executed in the past year and on any circumstances of non-compliance with the organisation's Treasury Management Policy Statement and TMPs.

The Executive will receive regular monitoring reports on treasury management activities and risks. The Audit Committee will have responsibility for the scrutiny of the treasury management policies or practices. Bolton will report the treasury management indicators as detailed in their sector specific guidance notes. The present arrangements and the form of these reports are detailed in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

TMP 7 - BUDGETTING, ACCOUNTING AND AUDIT ARRANGEMENTS

The responsible officer will prepare and Bolton Council will approve and, if necessary, from time to time will amend, an annual budget for Treasury Management which will bring together all of the costs involved in running the Treasury Management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 *Risk Management,* TMP2 *Performance Measurement* and TMP4 *Approved Instruments, Methods and Techniques*. The form Bolton Council's budget will take is set out in the Schedule to this document. The responsible officer will exercise effective controls over this budget and will report upon and recommend any changes required in accordance with TMP6 *Reporting Requirements and Management Information Arrangements*.

Bolton Council will account for its Treasury Management activities for decisions made and transactions executed, in accordance with appropriate accounting practices and standards and with statutory and regulatory requirements in force for the time being. The present form of Bolton Council's accounts is set out in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

Bolton Council will ensure that its Auditors and those charged with regulatory review, have access to all information and papers supporting the activities of the Treasury Management function as are necessary for the proper fulfilment of their roles and that such information and papers demonstrate compliance with external and internal policies and approved practices. The information made available under present arrangements is set out in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

TMP 8 - CASH AND CASH FLOW MANAGEMENT

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of the Authority will be under the control of the Director of Corporate Resources and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis and the responsible officer will ensure that these are adequate for the purposes of monitoring compliance with TMP1 (2) *Liquidity Risk Management*. The present arrangements for preparing cash flow projections and their form are set out in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

TMP 9 - MONEY LAUNDERING

Bolton Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions and will ensure that staff involved in this are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

TMP 10 - STAFF TRAINING AND QUALIFICATIONS

Bolton Council recognises the importance of ensuring that all staff involved in the Treasury Management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The responsible officer will recommend and implement the necessary arrangements.

The responsible officer will ensure that Council members tasked with treasury management responsibilities including those responsible for scrutiny have access to training relevant to their needs and responsibilities.

Those charged with the governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.

The present arrangements are detailed in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

TMP 11 - USE OF EXTERNAL SERVICE PROVIDERS

Bolton Council recognises that the responsibility for treasury management decisions remains with the Council at all times. It also recognises the potential value of employing external providers of Treasury Management Services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons which will have been submitted to a full evaluation of the costs and benefits. It will also 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. And it will ensure, where feasible and necessary, that a spread of service providers is used to avoid over reliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the Director of Corporate Resources and details of the current arrangements are set out in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section.

TMP 12 - CORPORATE GOVERNANCE

Bolton Council is committed to the pursuit of proper corporate governance throughout its business and services and to establishing the principles and practices by which this can be achieved. Accordingly, the Treasury Management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

Bolton Council has adopted and has implemented the key recommendations of the Code. This, together with the other arrangements detailed in the Treasury Management Documentation Papers maintained in the Tax & Treasury Section , are considered vital to the achievement of proper corporate governance in Treasury Management and the responsible officer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.

Annex 2

Counterparty List

(using the criteria set out in Paragraphs 31 -38 of the report)

Name	Fitch's				Moody's			S & P			
	Short Term	Long Term	Individual	Support	Short Term	Long Term	Fin Strength	Short Term	Long Term	Time Limit	Money Limit
United Kingdom (Sovereign Rating)	F1+	AAA				Aaa		A-1+	AAA		
Bank of New York Mellon (International) Ltd	F1+	AA-		1	P-1	Aaa	B+		AA-	3 years	£ 6 m
Bank of Scotland Plc.	F1	A		1	P-1	A1	D+	A-1	A	1 year	£ 10 m (EI)
Barclays Bank	F1	A	a	1	P-1	Aa3	C	A-1	A+	1 year	£ 4 m
Close Brothers	F1	A	a	5	P-1	A2	C+			1 year	£ 4 m (EI)
Co-operative Bank plc.	F2	A-	a-	3	P-2	A3	C-			1 year	£ 4 m
Credit Suisse First Boston International	F1+	AA-		1	P-1	Aa1		A-1	A+	1 year	£ 4 m
DB UK Bank Ltd					P-1	A2	C+			1 year	£ 4 m
UK Debt Management Office (which is an Executive Agency of HM Treasury)										No Limit	No Limit
HFC Bank	F1+	AA-		1	P-1	A3		A-1+	AA-	1 year	£ 4 m
HSBC Bank plc.	F1+	AA	aa-	1	P-1	Aa2	C+	A-1+	AA-	3 years	£ 6 m
Lloyds TSB Bank	F1	A	bbb	1	P-1	A1	C-	A-1	A	1 year	£ 10 m (EI)
Local Authorities											£ 10 m
MBNA Europe Bank	F1	A		1						1 year	£ 4 m
Money Market Funds											£ 10 m
Nationwide Building Society	F1	A+	a+	1	P-1	A2	C	A-1	A+	1 year	£ 4 m (EI)
National Westminster Bank	F1	A		1	P-1	A2	C-	A-1	A	1 year	£ 10 m (EI)
Royal Bank of Scotland	F1	A	bbb	1	P-1	A2	C-	A-1	A	1 year	£ 10 m (EI)
Santander UK plc.	F1	A+	a+	1	P-1	A1	C-	A-1+	AA-	1 year	£ 4 m (EI)
Standard Chartered Bank	F1+	AA-	aa-	1	P-1	A1	B-	A-1+	AA-	1 year	£ 4 m
Sumitomo Mitsui Banking Corporation Europe Limited	F1	A		1	P-1	Aa3	C	A-1	A+	1 year	£ 4 m

EI = Eligible Institution

Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service

A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks.

These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons in the monitoring reports and the Annual Treasury Report.

Yield – These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

Liquidity – This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

- Bank overdraft - £2m
- Liquid short term deposits of at least £5m available with a week's notice.

The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

- **WAL benchmark is expected to be between 0.25 and 0.5 years, with a maximum of 1 year** .

Security of the investments – In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poor's). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch long term rating category over the period 1990 to 2010.

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.02%	0.05%	0.10%	0.16%
AA	0.03%	0.06%	0.12%	0.17%	0.25%
A	0.08%	0.22%	0.40%	0.56%	0.74%
BBB	0.23%	0.69%	1.20%	1.77%	2.37%

The Council's minimum long term rating criteria is currently "A", meaning the average expectation of default for a one year investment in a counterparty with a "A" long term rating would be 0.08% of the total investment (e.g. for a £1m investment the average loss would be £800). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is: **0.08% historic risk of default when compared to the whole portfolio.**

Advice from Sector Treasury Services on the Expected Movement in Interest Rates

The Outlook for Interest Rates

February 2012

Growth in the UK economy is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Monetary Policy Committee inflation target. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

Fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16; the consequent increase in gilt issuance is therefore expected to be reflected in an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved.

This challenging and uncertain economic outlook has a several key treasury mangement implications:

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher 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 2012/13;
- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.