CITY COUNCIL - 9 FEBRUARY 2009

REPORT OF THE DEPUTY LEADER

REVIEW OF THE ANNUAL TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND STRATEGY FOR DEBT REPAYMENT

1 SUMMARY

This report sets out the following strategies for 2009/10 (and in the case of the first two the remainder of 2008/09):

- Treasury management strategy
- Investment strategy
- Strategy for debt repayment

The report was endorsed by Executive Board on 20 January 2009 with two additional recommendations to the Treasury Management Strategy 2009/10 as set out below.

2 RECOMMENDATIONS

IT IS RECOMMENDED that the strategies identified in paragraph 1 above and set out in Appendix A, B and Paragraph 4.5 of the report to Executive Board (which is attached in its entirety as Appendix 1) be approved, including the additional recommendations relating to the Treasury Management Strategy 2009/10:-

(1) that the total amount invested in money market funds be limited to £25m;
(2) that the Council's bankers, currently the Co-operative Bank, be added to the counterparty list with a maximum investment period of 5 days.

3 REASONS FOR RECOMMENDATIONS (INCLUDING OUTCOMES OF CONSULTATION)

3.1 To comply with:

- Financial Regulation 12 and the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on

Treasury Management by submitting a “policy and strategy” statement for the ensuing financial year.

- Guidance issued by the Secretary of State under section 15(1) (a) of the Local Government Act 2003 in approving at Council an Annual Investment Strategy before 1 April.
- Guidance issued by the Secretary of State under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 which requires the preparation of an annual statement of their policy on making a Minimum Revenue Provision (MRP).

3.2 To take account of the prevailing global and national economic position and the risks associated with operating in these environments.

3.3 To take into account the detailed discussion at and views of Audit Committee in their examination of the issues arising from the collapse of the Icelandic banks.

4 OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

4.1 To retain the existing temporary list to enable placement of funds with a wider range of institutions as the Council has significant cash values available. Until there is greater stability in the economy, this option is currently not recommended.

4.2 To expand the list to include counterparties having lower credit ratings. In the prevailing climate this is considered too high a risk and the option was rejected.

5 BACKGROUND

5.1 Treasury Management is subject to robust governance arrangements including legislation, government guidance, codes of practice and financial regulations. The approval of the three strategies relating to treasury management is good practice and ensures that the City Council complies with the governance framework.

5.2 The report to Executive Board on 20 January 2009 sets out the approach to developing the strategy and the factors taken into account in formulating the strategies. This report is attached as **Appendix 1.**

6 FINANCIAL IMPLICATIONS (INCLUDING VALUE FOR MONEY)

6.1 General Fund

Total treasury management payments comprise interest charges and receipts and provision for repayment of debt. A proportion of the City Council's debt relates to capital expenditure on council housing and this is recharged to the Housing Revenue Account (and funded through the Housing Subsidy system). The remaining costs are included within the Treasury Management section of the General Fund budget. The budget estimates associated with treasury management are set out in the table below.

REVENUE BUDGET POSITION			
	Budget 2008/09 £m	**Projected Outturn £m**	**Budget 2009/10 £m**
External Interest	28.1	28.3	28.7
Debt repayment provision	12.7	12.8	12.4
Less: HRA recharge	(12.5)	(12.8)	(13.5)
General Fund expenditure	**28.3**	**28.3**	**27.6**
Investment interest	(9.0)	(9.5)	(5.4)
Prudential Borrowing recharge	(4.3)	(4.9)	(5.6)
Net General Fund position	**15.0**	**13.9**	**16.6**

The estimates do not include any investment interest from the Icelandic banks.

Investment income

All current investments are for fixed periods and have fixed interest rates and the investment income is therefore known. Future income from investments is dependant on the general structure of interest rates, which can be extremely volatile as recent evidence testifies, and the type of counterparty with which the investment is placed. The interest rates offered tend to reflect the level of risk associated with the institution that the investment is placed with (although this is not the only reason for variations). By way of example, for a one month deposit, the Government's Debt Management Office are currently paying 1.00%, an F1+ rated UK clearing bank will pay around 1.50% and other F1+ institutions will pay 2.0%. Longer periods currently attract higher rates of interest.

The table below shows the estimated level of additional cash available for investment in 2009/10 (i.e. in addition to current investments) and the investment income that could be earned at interest rates of 1%, 2% and 3%. As a general rule of thumb a increase of 1% would generate approximately £1m additional interest in a full year:

MONTH	NEW INVESTMENT £m	INTEREST EARNED		
		1% £m	2% £m	3% £m
April 2009	62.1	0.052	0.104	0.155
May	67.4	0.056	0.112	0.169
June	74.5	0.062	0.124	0.186
July	87.7	0.073	0.146	0.219
August	96.3	0.080	0.161	0.241
September	114.0	0.095	0.190	0.285
October	113.0	0.094	0.188	0.283
November	113.0	0.094	0.188	0.283
December	108.0	0.090	0.180	0.270
January 2010	108.0	0.090	0.180	0.270
February	103.0	0.086	0.172	0.258
March	98.0	0.082	0.163	0.245
	Av = 95.4	**0.954**	**1.908**	**2.863**

7 RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS, CRIME AND DISORDER ACT IMPLICATIONS AND EQUALITY AND DIVERSITY IMPLICATIONS)

7.1 Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is prepared for the treasury function.

7.2 In 2004/05, a Treasury Management Reserve was created. This good practice provides a fund to deal with the inherent volatility in the Treasury Management budget. The balance on the fund at 1 April 2008 was £1.56m. Executive Board on 22 April 2008 approved the use of £0.345m to invest in the Local Education Partnership (the investment will be a combination of equity and debt and will be held for 25 years from the commencement of the Building Schools for the

Future contract). This fund will be used to offset some of the impact of the Icelandic banks issue and the reduction in investment interest due to falling interest rates.

7.3 As part of the risk management process it is good practice for the City Council to identify its risk appetite towards treasury management and in particular, given the current economic and banking problems, towards the investment of funds. In the current climate the City Council is adopting a low risk stance with the prime consideration being the security of funds. In adopting this approach the City Council must acknowledge the implications that this will have on the lower financial returns achievable and therefore the adverse impact on the revenue budget.

7.4 Given the prevailing economic climate and the inherent level of risk, the Strategy will be subject to regular review by the Treasury Management Panel throughout 2009/10. Any proposed changes will be brought forward to Executive Board and City Council if required. Audit Committee have also requested regular updates on the situation following on from their appraisal of the situation arising from the collapse of Icelandic banks. Overview and Scrutiny have also been briefed on these matters, with an update being provided to their January meeting.

8 LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

None.

9 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

Treasury Management in the Public Services – Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice 2002.
The Prudential Code for Capital Finance in Local Authorities – CIPFA

COUNCILLOR GRAHAM CHAPMAN
DEPUTY LEADER

<u>**EXECUTIVE BOARD – 20 JANUARY 2009**</u> **APPENDIX 1**

Title of paper:	**REVIEW OF THE ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGIES**	**Key Decision:** No
Chief Officer(s):	Carole Mills-Evans Deputy Chief Executive / Corporate Director, Resources	**Wards affected:** All
Portfolio Holder(s):	Councillor Graham Chapman, Portfolio Holder for Resources, Economic Development and Reputation	**Date of consultation with Portfolio Holder(s):** 6 January 2009
Contact Officer(s):	John Beevers, Head of Financial Projects, Programmes, Project Finance and Procurement Tel: 0115 9158224 E-mail: john.beevers@nottinghamcity.gov.uk	

<u>Summary of issues raised</u>:
This report sets out the treasury management and investment strategies covering the remainder of 2008/09 and 2009/10. It also includes the strategy for debt repayment in 2009/10.

	<u>Summary of recommendations</u>:	**<u>Summary of Implications</u>:**
	That Executive Board endorse and recommend for approval by the City Council at its meeting on 9 February 2009: • The overall Treasury Management Strategy for 2009/10 (also covering the remaining period of 2008/09) • The Investment Strategy for 2009/10 (also covering the remaining period of 2008/09) • The strategy for debt	Borrowing and investment activity will be undertaken in line with specific objectives and principles. The proposed changes to the investment strategy will provide additional flexibility in managing funds whilst minimising the associated risks. Treasury management activity for 2009/10 is predicted to be within the budget figures included in the

	repayment in 2009/10	medium term financial plan.
Impact on corporate objectives: Treasury management activities are part of the framework that drives the City Council's approach to effecting sound governance and modern best practice in delivering the Medium Term Financial Strategy (MTFS).		**Benefits to customers/service users:** Strong financial planning and management assist the City Council in delivering services to customers and service users in line with corporate priorities.

1 KEY DECISION

This matter is not the subject of a key decision.

2 RECOMMENDATIONS

2.1 That Executive Board endorse and recommend for approval by the City Council at its meeting on 9 February 2009:

- The overall Treasury Management Strategy for 2009/10 (also covering the remaining period of 2008/09)
- The Investment Strategy for 2009/10 (also covering the remaining period of 2008/09)
- The strategy for debt repayment in 2009/10.

3 REASONS FOR RECOMMENDATIONS

3.1 To comply with:

- Financial Regulation 12 and the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management by submitting a "policy and strategy" statement for the ensuing financial year.
- Guidance issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003 in approving at Council an Annual Investment Strategy before 1 April.
- Guidance issued by the Secretary of State under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 which requires the preparation of an annual statement of their policy on making a Minimum Revenue Provision (MRP).

3.2 To take account of the prevailing global and national economic position and the risks associated with operating in these environments.

3.3

To take into account the detailed discussion at and views of Audit Committee in their examination of the issues arising from the collapse of the Icelandic banks.

4 BACKGROUND

4.1 Treasury management is the management of an organisation's cash flows; ie: its borrowings and investments, the effective management of the associated risks and the pursuit of optimum performance or return consistent with those risks.

4.2 The treasury management function is governed by provisions set out under Part 1 of the Local Government Act 2003, whereby the City Council must have regard to the CIPFA Prudential Code and the CIPFA Code of Practice. The Prudential Code introduced new requirements for the way in which capital investment plans are considered and approved. In addition, the code introduced more integration between treasury management strategies and medium term financial planning activities.

4.3 **Treasury Management Strategy**

Section G of the Council's Medium Term Financial Strategy (MTFS) sets out the context for the Council's treasury management activities. The three strategic principles set out there are as follows:

G1 All borrowing and debt management activity will be carried out in accordance with the annually approved Treasury Management Strategy and the Manual of Treasury Management practices and Procedures, and within approved Prudential Indicators, having the highest regard for prudence, affordability and sustainability in the longer term.

G2 The management of the treasury investment portfolio will be in accordance with the approved investment strategy, with all investments complying with counterparty limits and restrictions.

G3 Appropriate use of prudential borrowing to fund capital investment will be made within prudential indicators and subject to medium term affordability.

This sets the overarching strategic context, within the Council's overall planning cycle for how treasury management activity will take place. Within this context, the proposed Treasury Management Strategy for 2009/10 appears at **Appendix A** with the main points summarised below:

- Factors in formulating the strategy

    - § The borrowing requirement for 2009/10 is estimated as £62.5m, at an average interest rate of 3.5%.
    - § The City Council has a projected average daily surplus of funds of £130m, which will be invested at an estimated average interest rate of 3.0% (this includes existing investments which are at average rates in excess of 6%).
    - § Short term interest rates (up to 364 days) are expected to fall in 2009/10.
    - § Long term interest rates (1 year onwards) are expected to fall in all periods but most significantly in periods up to 5 years.
    - § The prevailing situation and expected outlook for the global and national economies.
    - § The prevailing and expected level of risk within the global and national economies.
    - § The views of Audit Committee arising from their consideration of a draft strategy at their December meeting.

- Objectives of the strategy

    - § Economy – to achieve the lowest net interest rate costs, whilst recognising the risk management implications.
    - § Stability – to prevent the need for excessive borrowing in future years when rates may be unfavourable, and to protect the medium term financial plan from short term fluctuation in interest rates.

- The Strategy

    - § To borrow sufficient funds to meet the requirements of the capital programme, to replace maturing debt and meet any short term cash flow requirements.
    - § To restructure debt where revenue savings can be achieved, and ensure prudent management of the maturity profile.
    - § To manage the debt maturity profile within the limits established in the Prudential Indicators.
    - § To minimise the risk of the loss of principal of investments and maintain a spread of maturity dates for investments.

4.4 Annual Investment Strategy

The Investment Strategy is produced in accordance with guidelines produced by central Government. It is set out in detail in **Appendix B** and contains the following:

- Strategy guidelines
- Liquidity of investments
- The list of specified and non-specified investments
- The arrangements for monitoring credit ratings
- The policy on external investment managers

4.5 Annual Minimum Revenue Provision Statement

Under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (S.I. 2008/414) local authorities have a duty to produce an annual statement on their policy for making a minimum revenue provision (MRP). For 2009/10 the City Council will be adopting the following policies in determining the MRP:

- For any capital expenditure incurred prior to 31 March 2008 the City Council will be adopting the regulatory method (Option 1). This is where the MRP will be 4% of the opening capital financing requirement (CFR).
- For any capital expenditure incurred after 1 April 2008, and being financed by supported borrowing, the City Council will again be adopting the regulatory method (Option 1).
- For any capital expenditure incurred after 1 April 2008, and being financed by unsupported borrowing (General Fund and Housing Revenue Account) the authority will be adopting the asset life method (Option 3). This is where MRP will be based on the capital expenditure divided by a determined asset life to give equal annual instalments. It must be noted that once the asset life has been determined for this capital expenditure, it will not be altered in future years for the MRP repayment.

4.6 **Prudential Indicators**

The CIPFA Prudential Code introduced new requirements for the manner in which capital spending plans are to be considered and approved. The Code identifies certain statutory Prudential Indicators that the City Council are required to approve and monitor. In addition supplementary local indicators can be used where appropriate. These indicators are required to be approved before April 1 and are usually approved at the same time as the Treasury Strategy. However as they are closely linked with the revenue budget and capital programme, for 2009/10 they will be incorporated in the report on the medium term financial plan which will be considered by Executive Board in February and Council in March.

5 PROPOSALS

5.1 That the Treasury Management Strategy, the Annual Investment Strategy and the strategy for debt repayment for 2009/10 are approved.

6 TIMESCALE FOR IMPLEMENTATION OF PROPOSALS

6.1 The strategies will be implemented on approval by Council.

7 OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

7.1 To retain the existing temporary list to enable placement of funds with a wider range of institutions as the Council has significant cash values available. Until there is greater stability in the economy, this option is currently not recommended.

7.2 To expand the list to include counterparties having lower credit ratings. In the prevailing climate this is considered too high a risk and the option was rejected.

8 FINANCIAL IMPLICATIONS

8.1 **General Fund**

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March	98.0	0.082	0.163	0.245
	Av = 95.4	**0.954**	**1.908**	**2.863**

9 VALUE FOR MONEY

9.1 The proactive management of the City Council's borrowing and investment portfolio will assist in delivering value for money through minimising costs, maximising investment returns and minimising the risks involved.

10 LEGAL IMPLICATIONS

10.1 None as a result of this report.

11 RISK MANAGEMENT ISSUES

11.1 Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is prepared for the treasury function.

11.2 In 2004/05, a Treasury Management Reserve was created. This good practice provides a fund to deal with the inherent volatility in the Treasury Management budget. The balance on the fund at 1 April 2008 was £1.56m. Executive Board on 22 April 2008 approved the use of £0.345m to invest in the Local Education Partnership (the investment will be a combination of equity and debt and will be held for 25 years from the commencement of the Building Schools for the Future contract). This fund will be used to offset some of the impact of the Icelandic banks issue and the reduction in investment interest due to falling interest rates.

11.3 As part of the risk management process it is good practice for the City Council to identify its risk appetite towards treasury management and in particular, given the current economic and banking problems, towards the investment of funds. In the current climate the City Council is adopting a low risk stance with the prime consideration being the security of funds. In adopting this approach the City Council must acknowledge the implications that this will have on the lower financial returns achievable and therefore the
11.4 adverse impact on the revenue budget.

Given the prevailing economic climate and the inherent level of risk, the Strategy will be subject to regular review by the Treasury Management Panel throughout 2009/10. Any proposed changes will be brought forward to Executive Board and City Council if required. Audit Committee have also requested regular updates on the situation following on from their appraisal of the situation arising from the collapse of Icelandic banks. Overview and Scrutiny have also been briefed on these matters, with an update being provided to their January meeting.

12 CRIME AND DISORDER ACT IMPLICATIONS

12.1 None as a result of this report.

13 EQUALITY AND DIVERSITY IMPLICATIONS

13.1 None as a result of this report.

14 LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

14.1 PWLB records, budget working papers

15 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

Treasury Management in the Public Services – CIPFA Code of

Practice 2002
The Prudential Code for Capital Finance in Local Authorities - CIPFA

CHIEF OFFICER :	Carole Mills-Evans, Deputy Chief Executive / Corporate Director, Resources
CONTACT OFFICER :	John Beevers, Head of Financial Projects, Programmes, Project Finance and Procurement (58224 * john.beevers@nottinghamcity.gov.uk

Appendix A

Treasury Management Strategy 2009/10

1. The treasury management service is an important part of the overall financial management of the City Council's affairs and this importance has increased as a result of the freedoms provided by the Prudential Code.

2. The City Council's activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). The City Council adopted this code in February 2002, and as a result adopted a treasury management policy statement. This adoption complies with one of the requirements of the Prudential Code.

3. Specific objectives exist which underpin the Treasury Management Strategy and are as follows:

3.1 Borrowing

- To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio
- To manage the City Council's debt maturity profile, ensuring no single future year has a disproportionate level of repayments
- To maintain a view on current and possible future interest rate movements and borrow accordingly
- To monitor and review the balance between fixed and variable rate loans against the background of interest rate levels and prudential indicators

3.2 Investment

- The general policy objective for the City Council is the prudent investment of its treasury balances
- The City Council's investment priorities are:
    - The security of capital and
    - Liquidity of its investments
- All investments will be in sterling
- The City Council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity

4. The strategy covers:

- The expected movements in interest rates
- The City Council's borrowing and debt strategy
- The City Council's investment strategy (in compliance with government guidance)

5. Expected movement in interest rates

5.1 The Treasury Management Strategy seeks to protect the City Council from market related risks by proactively monitoring key factors such as interest rates and economic opinions both nationally and internationally. The table below shows actual rates for the four quarters to 30 September 2008 and projected rates until the end of March 2010.

Interest Rates 2007/2010								
		Money Rates				PWLB Rates		
Year	**End Period**	**Base Rate**	**3 mth**	**6 mth**	**12mth**	**5 yr**	**20 yr**	**50 yr**
2007	Dec	5.50	6.0	5.9	5.6	4.6	4.6	4.4
2008	Mar	5.25	6.0	6.0	5.8	4.1	4.7	4.4
	Jun	5.00	6.0	6.2	6.5	5.3	5.1	4.6
	Sep	5.00	6.3	6.4	6.5	4.4	4.8	4.6
	Dec	2.00	3.3	3.4	3.5	3.2	4.2	3.9
2009	Mar	1.50	2.5	2.6	2.8	3.0	4.1	3.8
	Jun	1.00	1.8	1.8	2.0	2.4	3.9	3.7
	Sep	1.00	1.5	1.6	1.7	1.9	3.8	3.7
	Dec	1.25	1.8	1.9	2.0	2.0	3.9	3.8
2010	Mar	1.50	1.9	2.1	2.2	2.1	3.9	3.8

5.2 There are significant risks to the forecasts and the yield curve could steepen for a number of reasons: the fall in short term interest rates could be viewed as being temporary; the prospects for inflation in the longer term will remain a concern; and the adverse impact of heavy gilt supply.

6. **Borrowing and Debt Strategy**

6.1 The City Council will borrow in respect of the following:

- Supported capital expenditure allocations
- Maturing debt (net of minimum revenue provision)
- Approved unsupported (prudential) capital expenditure
- To finance cash flow in the short term

6.2 The type, period, rate and timing of new borrowing will be determined by the Chief Finance Officer (CFO), under delegated powers, taking into account the following factors:

- Expected movements in interest rates
- Current maturity profile
- The impact on the medium term financial plan
- Prudential indicators and limits.

6.3 Opportunities for debt restructuring will be monitored and action taken by the CFO, under delegated powers, taking into account the following factors:

- The maturity profile – restructuring will only be actioned where it benefits the maturity profile
- Ongoing revenue savings will be achieved
- The impact of premiums and discounts has been fully considered
- The impact on prudential indicators has been fully assessed.

6.4 The estimated borrowing requirement for 2009/10 is £62.5m

7. **Investment Strategy**

7.1 All investments will be made in accordance with the City Council's investment policies and prevailing legislation and regulations. Any decisions to place an investment will include a risk assessment of the investment compared to the City Council's investment risk appetite.

7.2 Taking into account the criteria in **Appendix B** the maximum period we are planning to invest for is 6 months with the Debt Management Office and 3 months for all other institutions. It is estimated that the City Council will have investable funds of approximately £130m during 2009/10 (this is on the assumption that the investments with Icelandic banks are not repaid). The CFO will undertake the most appropriate form of investments depending on the prevailing interest rates at the time.

7.3 The position will be reviewed on a regular basis and reports provided to members and officers as appropriate.

Appendix B

<u>**Annual Investment Strategy 2009/10**</u>

1. Overview

1.1 The Secretary of State has issued guidance on investments in accordance with powers in the Local Government Act 2003 and local authorities are required to have regard to this guidance.

1.2 The general policy is that local authorities should invest prudently the surplus funds held on behalf of their communities.

1.3 The guidance recommends that priority should be given to security and liquidity. It is however appropriate to seek the highest rate of return consistent with the proper levels of security and liquidity.

1.4 The Secretary of State recommends that the strategy should be approved by the full Council before the start of the financial year. The strategy may be varied at any time during the year, again with the approval of the Council.

1.5 Any external investment managers employed by the City Council are contractually required to comply with the strategy.

2. Proposed Investment Strategy for Nottingham City Council

2.1 Strategy Guidelines

The primary principle governing the City Council's investment criteria is the security of its investments, although the yield is also a key consideration. After this main principle the City Council will ensure:

- It has sufficient liquidity in its investments. For this purpose we will set out procedures for determining the maximum periods for which funds may be prudently committed. These procedures also apply to the prudential indicators covering the maximum sums invested.
- It maintains a policy covering: the categories of investment types it will invest in; criteria for choosing investment

counterparties with adequate security; and the process for monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

2.2 Liquidity of investments

Due to the unprecedented economic situation the City Council will place funds with a maximum period to maturity of 6 months with the Debt Management Office and 3 months with all other institutions. This position will be kept under review and if and when it appears that the economic situation has become sufficiently settled a report will be brought back on proposals for extending the maximum period.

2.3 Specified Investments

2.3.1 An investment is specified if:

- It is sterling denominated
- It has a maturity of less than one year
- The making of the investment is not defined as capital expenditure
- The investment is made with a body which has been awarded a ‘high’ credit rating by a credit rating agency or is made with any one of the following:
  - § The United Kingdom Government
  - § A local authority in England and Wales or a similar body in Scotland or Northern Ireland
  - § A Parish Council or Community Council

2.3.2 A key element of the strategy is the protection of the principal amount invested. This is achieved through the approved counterparties the City Council can place deposits with, the limits on the amount that can be placed with any individual or group of counterparties, and that a range of deposit periods is employed. Following the collapse of the Icelandic banks, the Treasury Management Panel reviewed the approved counterparty list which had been approved by Council on 9 June, and as an interim measure, following consultation with the portfolio holder, the CFO implemented a temporary list from 24 October. This list included:

- The Debt Management office (DMO)

- Other local authorities
- The British institutions which were included in the UK Government's permanent capital investment and short-term liquidity support
- The Irish institutions which benefit from the Irish Government's guarantee for all deposits up to 30 September 2010
- Northern Rock, which is now a state owned bank and has a 3 month rolling Central Government guarantee for all wholesale deposits

The cash limit is £15m with any single counterparty, except the DMO and local authorities (£35m) with a maximum period of 6 months (except Northern Rock -3 months only).

2.3.3 The reduction of the counterparty list reduced risk but resulted in some difficulties in placing funds available for investment and has reduced the rate of return achieved. In order to provide sufficient further flexibility to place deposits, it is proposed that Money Market Funds are added to the temporary list. Money Market Funds are pooled, short maturity, high quality investment vehicles which buy money securities on behalf of retail or institutional investors and it is proposed that the minimum credit rating for these is AAA (security) and V1+ (volatility). The ratings shown are from Fitch but the equivalent from Moody's and Standard & Poor's could be used. These funds offer instant access so a maximum period for investment is not required. It is proposed that the maximum amount invested in each fund is £5m.

2.3.4 The other proposed changes are as follows:

- The limit of £35m with the DMO is removed and becomes unlimited. This will provide maximum flexibility in managing funds and the DMO is seen to be of the highest credit quality.
- The limit of 6 months with local authorities is reduced to 3 months.
- The limits with each of the British institutions and Northern Rock are reduced to £10m and 3 months.
- The Irish institutions are removed from the list.
- An overall group exposure limit of £10m is introduced

An overall upper limit for the total funds placed with the combined institutions of a particular country will also be introduced. However, as it is currently proposed to only place funds with UK institutions, this is not currently relevant. However, an initial upper limit of £25m for non-UK countries is proposed pending ongoing review throughout the next financial year.

2.3.5 Based on the proposed changes in 2.3.4 the list of specified investments for the City Council will be as follows:

Institution	Maximum Sum £m	Period
The UK Government (including the Debt Management Office)	Unlimited	6 months
Local authorities	35	3 months
British institutions which were included in the UK Government's permanent capital investment and short term liquidity support announced on October 10	10	3 months
Northern Rock, which is now a state owned bank and has a rolling 3 month central Government guarantee for all wholesale deposits.	10	3 months
Money Market Funds	5	Not applicable

A complete list of organisations that meet the new criteria is attached.

2.4 Non-Specified Investments

Investments which do not meet the criteria for specified investments are classified as non-specified investments. As we are only planning to invest for up to 6 months and only use organisations which have a 'high credit rating' or government support, then none of the City Council's investments will be classified as 'non-specified'.

2.5 Monitoring credit ratings

The only institutions on the lending list that will be based on credit ratings will be Money Market Funds. The credit ratings of these will be monitored on a daily basis. The City Council receives credit rating advice from Butlers and this will be used to review the counterparty list. In addition to the main ratings we will also monitor the ratings relating to volatility and also the implications of ratings watch and ratings outlook statements. If a rating is downgraded on an institution with whom the City Council has an existing investment then the following action will be taken:

- If it goes below the minimum criteria we have established, the risk implications will be assessed, including discussions with our external advisors, and if it is deemed appropriate a request will be made to return the investment
- If it remains within the investment criteria then the risk implications will be assessed, including discussions with our external advisors, and the position monitored.

2.6 Portfolio management

Currently the City Council's entire investment portfolio is managed in-house by treasury management officers, with guidance from our appointed advisors and all existing investments are in the form of cash deposits. In the 2008/09 strategy it was proposed to place a proportion of the portfolio with an external cash manager to assist in maximising the return from such deposits.

Given the Icelandic banks issue and the reduction in the counterparties that are used it has been decided not to pursue the appointment of a cash manager for the time being. This position will be reviewed during 2009/10 and if it is considered that the position has changed then a report will be brought forward to enable further discussion on the matter.

Money Market Fund Ratings

Security

Fitch AAA
Highest credit quality. ‘AAA’ ratings denote the lowest expectation of credit risk. They are assigned only in the case of exceptionally strong capacity for payment of financial commitments. The capacity is highly unlikely to be adversely affected by foreseeable events.

Moody’s Aaa
Money market funds rated Aaa are judged to be of an investment quality similar to Aaa-rated fixed income obligations – that is, they are judged to be of high quality by all standards.

Standard & Poor’s AAAm
A fund rated ‘AAAm’ has extremely strong capacity to maintain principal stability and to limit exposure to principal losses due to credit, market and/or liquidity risks. ‘AAAm’ is the highest principal stability fund rating assigned by Standard & Poor’s.

Volatility

Fitch V-1+
The ‘V-1+’ rating is assigned only to money market funds that should not experience loss of principal value to shareholder or participants even in severely adverse interest rate environments.

Moody’s MR1+
Money market funds rated MR1 are judged to have very low sensitivity to changing interest rates and other market conditions. The + sign denotes constant net asset value funds.

Standard & Poor’s S1+
Funds that possess low sensitivity to changing market conditions are rated S1. The + sign indicates the fund’s extremely low sensitivity to changing market conditions

PROPOSED LIST OF INSTITUTIONS FOR INVESTMENT							
	Maximum amount £m	**Credit Ratings**					
		Fitch		**Moody's**		**Standard & Poor's**	
1. British Institutions included in the UK Government's permanent capital investment and short term liquidity support		Short Term	Long Term	Short Term	Long Term	Short Term	Long Term
UK Banks							
Abbey National Plc	10	F1+	AA-	P-1	Aa3	A-1+	AA
Bank of Scotland Plc	10	F1+(N)	AA(N)	P-1	Aa1(N)	A-1+(P)	AA-(P)
HSBC Bank plc	10	F1+	AA	P-1	Aa1	A-1+	AA
Lloyds TSB Bank	10	F1+	AA+(N)	P-1	Aaa	A-1+	AA(N)
Royal Bank of Scotland	10	F1+	AA-	P-1	Aa1	A-1+	AA-
Barclays Bank	10	F1+	AA	P-1	Aa1(N)	A-1+	AA(N)
Northern Rock PLC	10	F1+	A-(P)	P-1	A2	A-1	A
UK Building Societies							
Nationwide Building Society	10	F1+	AA-	P-1	Aa2	A-1	A+
2. The UK Government (including the Debt Management Office)	Unlimited						
3. Local Authorities	35						

4. Money Market Funds	5						