

CHERWELL DISTRICT COUNCIL

Treasury Management Policy and Annual Investment Strategy 2009/10

Overview

The Local Government Act 2003 requires the Council to 'have regard to 'the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The prudential indicators set out in Annex 1a consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework.

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

The Outlook for Interest Rates

The UK economy has entered a profound recession, worsened by a dangerous combination of negative growth and dislocation in the domestic and world financial markets. The situation in the economy is considered critical by the policy setters who are concerned that the testing financial environment, the sharp decline in house prices and persistently tight credit conditions could trigger a collapse in consumer confidence. At best this could deliver a short, sharp downturn, at worst a prolonged Japanese-style recession.

The sharp downturn in world commodity, food and oil prices, the lack of domestic wage pressures and weak retail demand promises a very steep decline in inflation in the year ahead. In the recent pre-Budget Report, the Treasury suggested RPI inflation could fall to minus 2.25% by September 2009. Inflation considerations will not be a constraint upon Bank of England policy action. Indeed, the threat of deflation strengthens the case for more aggressive policy ease.

The Government's November pre-Budget Report did feature some fiscal relaxation but it also highlighted the very poor health of public sector finances. The size of the package is considered insufficient to kick-start the economy. The onus for economic stimulation will fall upon monetary policy and the Bank of England.

The Bank will continue to ease policy and the need to drive commercial interest rates, currently underpinned by the illiquidity of the money market, to much lower levels suggests the approach will be more aggressive than might otherwise have been the case. A Bank Rate below 1% now seems a distinct possibility and short-term LIBOR rates of below 2% may result. Only when the markets return to some semblance of normality will official rates be edged higher.

Long-term interest rates will be the victim of conflicting forces. The threat of deep global recession ought to drive bond yields to yet lower levels. But much of this is already discounted. The prospect of exceptionally heavy gilt-edged issuance in the next three years (totalling in excess of £100bn per annum), as the Government seeks to finance its enormous deficit, together with concerns about UK inflation further into the future will maintain upward pressure on yields, in spite of the fact that negative RPI inflation in 2009 will raise the level of real yields significantly this year.

Interest Rate Forecasts – 2007/2010

Year	End Period	Money Rates				PWLB Rates*		
		Bank Rate	3mth	6mth	12-mth	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	3.0	3.2	3.3	3.0	4.2	4.0
2009	Feb 11th	1.50	2.0	2.3	2.4	2.8	4.4	4.3
	Mar	1.00	2.0	2.2	2.4	2.6	4.5	4.4
	Jun	0.50/0.75	1.5	1.6	1.8	2.4	4.7	4.6
	Sep	0.50/0.75	1.5	1.6	1.7	2.4	4.9	4.8
	Dec	1.00	1.6	1.7	1.8	2.5	4.9	4.8
2010	Mar	1.25	1.7	1.9	2.0	2.6	4.9	4.8

Medium-Term Rate Estimates (averages)

Annual Average %	Bank Rate	Money Rates		PWLB Rates*		
		3 month	1 year	5 year	20 year	50 year
2008/09	3.9	5.0	5.3	4.2	4.8	4.5
2009/10	1.0	1.6	1.8	2.4	4.8	4.7
2010/11	1.7	2.1	2.8	3.2	4.9	4.8
2011/12	2.4	2.8	3.6	4.0	5.1	4.9

* Borrowing Rates

Source - Butlers

Minimum Revenue Provision (MRP) Policy

As the authority is debt free and has no plans to borrow in the near future there is no requirement to make a Minimum Revenue Provision (MRP) for the repayment of debt in 2009/10; neither was an MRP required for 2008/09.

Annual Investment Strategy

Introduction

The Office of the Deputy Prime Minister (now CLG) issued Investment Guidance on 12th March 2004, and this forms the structure of the Council's policy. The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield.

In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code in March 2002 and will apply its principles to all investment activity. Under the Code

the Council is required to formulate a strategy each year regarding the investment of its revenue funds/capital receipts pending their use.

The key requirements of both the Code and the Investment Guidance are for the Council to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for decision making on investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security and high liquidity investments denominated in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The main principles governing the Council's investment criteria are:

- a) Minimise risk of capital loss – the prime objective of our treasury management activities is to ensure the security of the amounts invested. This is managed by using a counterparty list which only includes organisations having a suitable credit rating and which has a maximum amount that can be invested with each organisation at any one time.
- b) Yield – the budget requirement for 2009/10 is £2.8m and this will be regularly monitored and reported through the Performance Management Framework.
- c) Liquidity – investments are linked to known future cash flows to ensure sufficient funds are available as and when they are required.
- d) To have a minimum on daily call of £5.0m ;

Current Investment Position (as of 26 Feb 2009)

Fund	Financial Instrument	£m
Money Market	Money market call account	3.4
In-House/TUK-	Managed fixed term deposits	64.0
Investec	Managed certificates of deposit	26.0
Total		93.4

The duration of the Money Market, In-house and TUK funds is:-

Maturity Ladder	£m
Daily Call	3.4
Mature pre 31.3.2009	16.0
Mature 2009/10	30.5
Mature 2010/11	7.5
Mature 2011/12	5.0
Mature 2012/13	5.0
TOTAL	67.4

The In House function is primarily one of cash flow management with investments made to match future financial commitments, where known. The Council banks with NatWest plc and has a £1.0m overdraft facility.

In order to provide the necessary flexibility, it is important to keep an element of funds available on a daily basis. This is done using a Money Market Fund with Royal Bank of Scotland which is currently paying 1.54%. From past experience, a minimum of £5.0m on daily call has been adequate but this is currently subject to review.

Specified Investments

These investments are:

- sterling-denominated;
- of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months, if it wishes.
- low risk assets where the possibility of loss of principal or investment income is small.

Specified Investments would include investments with:

- A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society (*although low or non-rated building societies will need to be non-specified investments*)). The Council will invest in banks and building societies which meet the following criteria in respect of credit ratings, and period of investment:

Criteria	Fitch	Moody's	Standard & Poor's
Short Term Rating	F1	P-1	A-1
Maximum Period	1 year	1 year	1 year

- The UK Government (such as the Debt Management Office, UK Treasury Bills or a Gilt with less than one year to maturity).
- Supranational bonds of less than one year's duration.
- A local authority, parish council or community council.
- Pooled investment vehicles (such as money market funds) that have been awarded a high (AAA) credit rating by a credit rating agency (Standard and Poor's, Moody's or Fitch)

Non-Specified Investments

Non-specified Investments are any other type of investment (i.e. not meeting the definition of Specified Investments set out above). The identification and rationale supporting the selection of Non-Specified Investments and the maximum limits to be applied are set out below.

Non specified investments would include any sterling-denominated investments in/with:

- Any bank or building society that has a minimum long term credit rating of A-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).

- Building societies not meeting the basic security criteria for Specified Investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The council may use such building societies which have a minimum asset size of £1,000m, but will restrict these types of investments to 1 year.
- Supranational Bonds greater than 1 year to maturity
 - (a) Multilateral development bank bonds - these are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.)
 - (b) A financial institution that is guaranteed by the United Kingdom Government

The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt-edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.
- Gilt-edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.
- Share capital or loan capital in a body corporate – the use of these instruments would be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies.

The Council will use the following criteria to set the time and overall amount of monies which will be invested in these bodies.

Non-rated Building Societies

Criteria	Asset Size
	Exceeding £1bn
Short Term Rating	n/a
Maximum Period	One year
Maximum Investment	£1.00m

Longer Term Investments – up to 3 years

Criteria	Fitch	Moody's	Standard & Poor's
Short Term Rating	F1	P-1	A-1
Long Term Rating	A-	A3	A
Individual Rating/FSR	C	C	n/a
Support Rating	3	n/a	n/a
Maximum Investment	£4.0m	£4.0m	£4.0m

Longer Term Investments – up to 5 years

Criteria	Fitch	Moody's	Standard & Poor's
Short Term Rating	F1+	P-1	A-1+
Long Term Rating	AA-	Aa3	AA-
Individual Rating/FSR	B	B	n/a
Support Rating	3	n/a	n/a
Maximum Investment	£5.0m	£5.0m	£5.0m

Use of External Fund Managers

It is the Council's policy to use the services of external fund managers to manage part of its investment portfolio. We currently use Investec Asset Management and Tradition UK.

TUK currently have £29m of the Council's funds to invest, received as follows:

Date	Transaction	£m
05/02/1997		10
03/09/2002		10
01/10/2005		9
		29

Investec Asset Management currently has £26m of the Council's funds to invest, received as follows:

Transaction Date	£m	Note
02/07/2001	10	
18/10/2002	10	
24/03/2003	-7.5	repaid to us to repay our PWLB loan - this is when we became debt free
29/03/2004	7.5	given back to Investec when we sold our housing stock
Accrued Interest	6	
	26	

The fund managers will use both Specified and Non-Specified investment categories, and are contractually committed to adhere to the Council's Investment Strategy.

The parameters of the external fund managers' investment mandates are as follows:

Investec (Fund Manager) – Cash investments, including certificates of deposit, are to be in accordance with Investec's own counterparty list. In addition the following parameters will apply:

- The maximum single investment in any one organisation is limited to 20% of the fund.
- A maximum of 75% of the fund to be in gilts, corporate bonds, sovereign bonds, supranational bonds and floating rate notes
- No gilt is to be for longer than 10 years
- A maximum of 25% of the fund to be in corporate bonds, sovereign bonds, supranational bonds, floating rate notes
- A maximum of 10% of the fund to be in corporate bonds with a maximum of 2.5% in any single corporate bond
- A maximum of 10% (approx. £2m) of the fund to be in any single sovereign or supranational bond.

These arrangements will continue until the basis of any future arrangement with Investec is finalised.

TUK (Cash Manager) - All investments to be cash investments in line with the counterparty list and maximum limits in operation at the time. The combined totals of In-house and TUK-managed investments shall not exceed the maximum limits in this document. Forward deals within the specified limits are permitted.

The performance of each manager is reviewed at least quarterly by the Head of Finance. Both Investec and TUK have performed above the agreed benchmark and above the industry average in the current year to date.

Investment Counterparties

The Head of Finance will maintain a list of approved investment counterparties attached in Annex 1b. The Council receives credit rating advice from its advisers, Butlers, on a daily basis, and as and when ratings change, and counterparties are checked promptly. Approval of counterparties will be subject to the potential counterparties satisfying the minimum criteria set out below with three rating agencies (the “lowest common denominator” approach). These criteria are used to select which counterparties the Council will choose rather than defining what its investments are. The Head of Finance will revise the criteria and submit them to Council for approval, as necessary.

	Short Term	Long Term	Individual/Financial Strength	Support
Fitch	F1	A-	C	3
Moody's	P-1	A3	C	N/A
Standard & Poors	A-1	A	N/A	N/A

The credit rating of counterparties will be monitored regularly. The Council receives credit rating advice from its advisers, Butlers, on a daily basis, and as and when ratings change, the 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 Head of Finance, and if required new counterparties which meet the criteria will be added to the list.

Treasury Management Performance Indicators

The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are:

- Debt – Borrowing - Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate
- Investments – External fund managers - returns 110% above 7 day compounded LIBID.

In addition, the following Investment Performance Indicators are monitored by the Council on a monthly basis:

- £ actual investment income versus annual budget
- % rate of return (average interest rate) on In-house managed investments versus target
- % rate of return (average interest rate) on TUK - managed investments versus target
- % rate of return (average interest rate) on Investec-managed investments versus target. In addition, Investec reports monthly on its rate of return benchmarked against 7 day LIBID, 3 month LIBID and a composite LIBID/gilt index
- % ratio of short term (< 365 days) versus long-term investments
- £ amount of investments available on-call

The results of these indicators will be reported to the Executive in the Treasury Management Annual Report for 2008/09.