BUSINESS SUPPORT
OVERVIEW AND SCRUTINY COMMITTEE
27 JANUARY 2011
TREASURY MANAGEMENT STRATEGY 2011/2012

Report from: Mick Hayward Chief Finance Officer

Author: Andy Larkin Finance Support Manager

Summary

This report seeks the scrutiny of the Council's Treasury Management Strategy for the 2011/2012 financial year. The Treasury Management Strategy incorporates within it the Treasury Management Policy Statement, Annual Investment Strategy and Minimum Revenue Provision policy.

1. Budget and Policy Framework

1.1 Business Support Overview and Scrutiny is responsible for the scrutiny of the Council's Treasury Management, Investment Strategy and Minimum Revenue Provision Policy Statement.

1.2 Following scrutiny by Business Support Overview and Scrutiny, Cabinet will consider the strategy taking into account this committee's comments;

1.3 Approving Policy and the setting of prudential indicators is a matter for Council.

1.4 The Chairman has agreed to accept this item as an urgent item for consideration at this meeting to enable this report to be scrutinised by this Committee prior to going to Cabinet on 15 February 2011.

2. Background

2.1 Treasury management is defined as:

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

2.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 25 February 2010*.*

2.3 The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices, this has been delegated to Cabinet and for the execution and administration of treasury management decisions has been delegated to the Chief Finance Officer.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body, this has been delegated to Business Support Overview and Scrutiny.

2.4 The suggested strategy for 2011/2012 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Sector.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- Prudential and Treasury Indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- the MRP strategy

2.5 In exercising the delegations to fulfil the responsibilities set out in the Treasury Management Strategy the Council will establish a set of standards to govern the manner in which these responsibilities are exercised. These standards are referred to as the Treasury Management Practices and are attached at Appendix 7 and are the detail by which the Chief Finance Officer will ensure the proper stewardship of the Treasury function is maintained.

3. Balanced Budget Requirement

3.1 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future

4. Treasury Limits for 2011/12 to 2013/14

4.1 It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the “Affordable Borrowing Limit”. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

4.2 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is ‘acceptable’.

4.3 Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years; details of the Authorised Limit can be found in Appendix 3 of this report.

4.4 For 2012/2013 the current Housing Subsidy regime will cease in favour of a new ‘self-financing’ model which will involve the transfer of the current liability under the subsidy calculation into a debt burden. The current consultation suggests that this will be in the order of an additional £11 million of borrowing against the Housing Revenue Account. At present it is unclear as to whether this will feature in the capital financing requirement calculation as debt incurred on 31 March 2012 or the 1 April 2012. The authorised limit is currently including this additional debt as part of the limit for 2012/2013 but clearly this will be affected by both the value and timing of any such debt transfer. Officers believe that the adjustment in 2012/2013 is appropriate and that the value is within the tolerance for the authorised limit. Clearly if circumstances dictate a change in that view it will be reported to Members.

5. Current Portfolio Position

5.1 The Council's treasury portfolio position as at 31 March 2011 is anticipated to be:

Table 1		**Principal**		**Ave. rate**
		£m	£m	%
Fixed rate funding	PWLB	71.43		
	Market	101.80	173.23	4.13
Variable rate funding	PWLB	0.00		
	Market	0.13	0.13	0.50
Other long term liabilities			0.00	
Gross debt			**173.36**	
Inhouse Investments		57.90		1.00
Investec Investments		22.45		1.00
Total investments			**80.35**	
Net debt			**93.01**	

6. Borrowing Requirement

6.1 The Council's borrowing requirement is as shown in table 2 and indicates a lack of external borrowing for the foreseeable future because of the relative position of investment returns and rates for new borrowing.

Table 2	**2010/2011**	**2011/2012**
	£'000 probable	**£'000 estimate**
New supported borrowing	12,088	5,333
New prudential borrowing	3,743	2,500
Replacement borrowing	0	0
Total borrowing requirement	15,831	7,833

Note: all new borrowing is currently using internal funds rather than PWLB or the market

7 Prudential and Treasury Indicators for 2011/2012 – 2013/2014

7.1 Prudential and Treasury Indicators (as set out in tables 5, 6 and 7 in appendix 3 to this report) are relevant for the purposes of setting an integrated treasury management strategy.

7.2 The Council is required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on 17 February 2002 and the revised 2009 Code was adopted by the full council on 25 February 2010.

8. Prospects for Interest Rates

8.1 The Council has appointed Sector as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Appendix 2 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Sector Bank Rate forecast for financial year ends (March)

- 2010/ 2011 0.50%
- 2011/ 2012 1.00%
- 2012/ 2013 2.25%
- 2013/ 2014 3.25%

8.2 There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected. A detailed view of the current economic background is contained within Appendix 4 to this report.

9. Borrowing Strategy

9.1 Borrowing rates

9.1.1 The Sector forecast for the PWLB new borrowing rate is as follows: -

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Bank Rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%	2.75%
5Yr PWLB	3.30%	3.30%	3.40%	3.50%	3.60%	3.80%	3.90%	4.10%	4.30%	4.60%
10Yr PWLB	4.40%	4.40%	4.40%	4.50%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
25yr PWLB	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%
50yr PWLB	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%

9.1.2 A more detailed Sector forecast is included in Appendix 2.

9.2 As referred to in paragraph 6.1, due to the very low interest rates being earned on investments and restrictions to mitigate counterparty risk, officers will be repaying existing and deferring taking out new debt. However, in the event that it was deemed advantageous to borrow then we will evaluate the economic and market factors to form a view on future interest rates so as to determine the manner and timing of decisions to borrow.

9.3 Sensitivity of the forecast – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- *if it were felt that there was a significant risk of a sharp FALL in long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

10. External v. internal borrowing

TABLE 3: Comparison of gross and net debt positions at year end	**2009/2010**	**2010/2011**	**2011/2012**	**2012/2013**	**2013/2014**
	actual	**probable out-turn**	**estimate**	**estimate**	**estimate**
	£'000	£'000	£'000	£'000	£'000
Actual external debt (gross)	198,408	173,361	163,325	153,312	143,312
Cash balances	88,779	80,349	74,293	25,108	19,771
Net debt	109,629	93,012	89,032	128,204	123,541

10.1 It is anticipated that the difference between gross debt and net debt (after deducting cash balances), by the end of the current financial year will be £80m.

10.2 The general aim of this treasury management strategy is to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. However, measures taken in the last year have already reduced substantially the level of credit risk (see paragraph 9.2) so another factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

10.3 The next financial year is expected to be one of historically abnormally low Bank Rate. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.

10.4 Over the next three years, investment rates are therefore expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

10.5 However, short term savings by avoiding new long term external borrowing in 2011/2012 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.

10.6 The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that large premiums would be incurred by such action and would also do so in the near term; such levels of premiums cannot be justified on value for money grounds. This situation will be monitored in case these differentials are narrowed by the PWLB at some future date.

10.7 Against this background caution will be adopted with the 2011/2012 treasury operations. The Chief Finance Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the next available opportunity.

11. Policy on borrowing in advance of need

11.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

11.2 In determining whether borrowing will be undertaken in advance of need the Council will: -

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use

- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

12. Debt Rescheduling

12.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings might still be achievable through using LOBO (Lenders Option Borrowers Option) loans, and other market loans, in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

12.2 As short term borrowing rates will be considerably cheaper than longer-term rates, there may be potential for some residual opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the size of premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

12.3 The reasons for any rescheduling to take place will include: -

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the strategy outlined in paragraph 9 above
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

12.4 Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

13. Annual Investment Strategy

13.1 <u>Investment Policy</u>

13.1.1 The Council will have regard to the CLG’s Guidance on Local Government Investments (“the Guidance”) and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”). The Council’s investment priorities are: -

(a) The security of capital and
(b) The liquidity of its investments.

13.1.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

13.1.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

13.1.4 Investment instruments identified for use in the financial year are listed in Appendix 5 under the ‘Specified’ and ‘Non-Specified’ Investments categories.

13.2 Creditworthiness policy

13.2.1 This Council uses the creditworthiness service provided by Sector. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

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

13.2.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

13.2.3 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector’s weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands which are colour coded for ease of recognition*:*

- Yellow 5 years *
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

** Sector note: this category has been added for AAA rated Government debt or its equivalent; please also see collateralised deposits added into Appendix 5 as a new investment instrument.*

13.2.4 This Council does not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys tend to be more aggressive in giving lower ratings than the other two agencies. In practice this means an over reliance on the one agency view and if applied could leave the Council with few banks on its approved lending list. The Sector creditworthiness service does still use ratings from all three agencies, but by using a risk weighted scoring system, does not give undue preponderance to any one agency's ratings.

13.2.5 All credit ratings will be monitored continuously by Officers. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

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

13.2.7 Investec use the following methodology to compile its counterparty list:

(a) Ratings set by Fitch IBCA

(b) Credit Default Swap levels (CDS's)

(c) Subjective Overlay

13.2.8 The Fund Managers "score" the markets current attitude to our counterparties on the standard lending list.

13.2.9 Scores are given for the following three important tests:

1. Will a bank buy back its own certificates of deposits (CDs) from us? If the answer is "Yes" this is seen as a signal that there is satisfactory liquidity and a low score will result. A "No" will lead to a high score to reflect the more restricted liquidity and the need to use the secondary market in order to dispose of a holding.

2. Is the bank a frequent or rare issuer of CDs? Frequent issuers are likely to be less attractive in the secondary market (e.g. investment houses "may be full of the name" or the issuing bank may be viewed as having an above average need for new funding). Rare issuers will be more highly regarded.

3. Do CDs issued by the banks trade "well" in the secondary market? The market's appetite for CDs is seen as a signal about credit concerns or otherwise for any bank.

13.3 Counterparty Limits

13.3.1 Limits need to be set for amounts invested with any individual counterparty at any given moment. The relevant limits are currently set at £20m per counterparty for the in-house team and 20% of the managed portfolio for the fund manager. With these limits and the current in-house portfolio of an average of some £80 million there have been occasions when the in-house team have been stretched to invest at reasonable returns.

13.3.2 The Academy programme currently underway will add to these difficulties in that it is anticipated that in March 2011 the Council will be in receipt of an initial funding grant of £26.6m with a further two instalments in the summer of 2011 totalling approximately £50m for the funding of the building of these three new academies. This will result in the need to invest approximately an additional £70m above our current levels in the summer of 2011 although this will diminish as the cash outflows occur.

13.3.3 Officers are investigating various proposals on how this money should be invested, within the policy dictated above. However, to assist in this it is suggested that the in-house counterparty limit is raised to £25m for counterparties with a Sector duration rating of 12 months or above. This would have the effect of increasing officers' ability to invest a further £35m in the highest rated counterparties.

13.3.4 In addition to this, officers are investigating adding further high quality counterparties to our in-house list, extending the use of Money Market Funds and increasing the sum invested via our fund manager. All initiatives will be within the approved Treasury Strategy and will be carefully considered by the Chief Finance Officer.

13.3.5 No amendments are requested to the Fund Manager counterparty limits.

13.3.6 The in-house team and Fund Manager both have the ability to invest unlimited sums with the Debt Management Agency Deposit Facility as this is effectively an office of Central Government. The down side to this investment is that the rate of return is very low (currently circa 0.2%).

13.4 Country limits

13.4.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide a rating). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

13.4.2 The Country limit will be reinforced by the application of a financial limit to investment such that a maximum of £40 million may be invested in any one country save for the United Kingdom where no limit is imposed.

13.5 Investment Strategy

13.5.1 In-house funds: The Council's in-house managed funds are derived from core balances and cash flow activity. The major part of these funds would normally be available for medium-term investments (less than 3 years). However the policy of running down balances to reduce credit risk and revenue costs from borrowing, as against minimal investment returns, means that such medium-term investments are very unlikely. Officers will monitor this position and if advantageous, then investments will accordingly be made with reference to the core balance, cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

13.5.2 Shown below are investments already made that extend into 2011/2012

	Amount £m	*Maturity*	*Rate*
NatWest Bank (Flippable Range Accrual)	*10*	*26/09/2011*	*0.35% over 3mth LIBOR reset every 3 months. Current rate 1.10563%*
Lloyds TSB	*20*	*23/11/2011*	*1.95%*

13.5.3 Interest rate outlook: Bank Rate has been unchanged at 0.50% since March 2009. and commentators forecast rates to remain at this level until quarter 3 of 2010 and then to rise steadily from thereon. This will obviously be affected by economic factors as they fall but Bank Rate forecasts for financial year ends (March) are as follows: -

- 2010/ 2011 0.50%
- 2011/ 2012 1.00%
- 2012/ 2013 2.25%
- 2013/ 2014 3.25%

13.5.4 There is downside risk to these forecasts if recovery from the recession proves to be weaker and slower than currently expected.

13.5.5 The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this council.

13.6 End of year investment report

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

13.7 External Fund Manager

13.7.1 £22.3m of the Council's funds are externally managed on a discretionary basis by Investec Asset Management.

The Council's external fund manager(s) will comply with the Annual Investment Strategy. The agreement between the Council and the fund manager additionally stipulate guidelines and duration and other limits in order to contain and control risk.

For Investec the minimum credit criteria to be used by the cash fund manager(s) are as follows: -

	Fitch
Long Term	AA-
Short Term	F1+
Individual/Financial Strength	C
Support	1

13.8 Policy on the use of external service providers

13.8.1 The Council uses Sector as its external treasury management advisers.

13.8.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

13.8.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

14 Kent County Council (KCC) Local Government Reorganisation (LGR) Debt

14.1 The charge for the share of KCC debt for which Medway Council was responsible on local government reorganisation is based on the current average cost of debt for the County Council as a whole. KCC rates had been decreasing year-on-year as the County took on cheaper new debt but this has recently marginally reversed as the repayment of debt for the cheaper short-term loans distills costs to the higher rates. Whilst the County rate at a projected 5.21% remains marginally higher than our own average debt rate of 4.27% for 2010/2011, the margin between PWLB debt rates for new borrowing and restructured debt (currently 5.46% vs 4.35% for 25 year borrowing) is such that this saving would be negated by the penalty involved. The outstanding principal at 1 April 2011 will be £47.1m.

Table 4 - Current and Historical Rates of Interest Charged on KCC LGR debt

Year	2006/07 Actual	2007/08 Actual	2008/09 Actual	2009/10 Actual	2010/11 Estimate	2011/12 Estimate
Rate	5.77%	5.74%	5.51%	5.08%	5.21%	5.34%

15. Minimum Revenue Provision

15.1 The Minimum Revenue Provision is explained and the Policy Statement for 2011/2012 is set out at Appendix 1. The MRP calculation is currently being reviewed by officers, in order to apply the most financially advantageous and yet prudent approach to MRP. The Policy shown as Appendix 1 is based upon the existing MRP Policy Statement but amended to include variations recommended by our consultant advisors, Sector.

16 Risk management

16.1 As stated within the Treasury Strategy, a key driver for the review of the CIPFA code has been the exposure to risk evidenced by the Icelandic investments and more generally by the financial crisis. Risk and the management thereof is a feature throughout the strategy and in detail within the treasury management Practices 1 within the Treasury strategy.

17. Financial and legal implications

17.1 The Finance and Legal positions are set out throughout the main body of the report.

18. Recommendations

18.1 Members are requested to scrutinise this report, note it's contents and pass comments onto Cabinet and Council.

Lead officer contact

Author: Andy Larkin, Finance Support Manager, Gun Wharf, 01634 332317
andrew.larkin@medway.gov.uk

Background papers

Various records and documents held within Finance
Investec reports
Sector reports.

Appendices

1. MRP strategy
2. Interest rate forecasts
3. Prudential and Treasury indicators
4. Economic background
5. Specified and non specified investments
6. Approved countries for investments
7. Treasury Management Practices

APPENDIX 1

Minimum Revenue Provision

1. What is a Minimum Revenue Provision?

The Council uses borrowing to fund some items of Capital expenditure which is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. The Council is obliged to repay the principal sum borrowed together with any interest attached to the borrowing. The repayment of principal has to be set aside from revenue and it would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred. The amount to be provided is therefore spread over time such that the total sum is available to cover the liability for repayment as it occurs. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and is now determined under Guidance.

2. Statutory duty

Statutory Instrument 2008 no. 414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).

There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year (in practice this would mean that there is no outstanding borrowing to repay).

The share of Housing Revenue Account CFR is not subject to an MRP charge and excluded from the calculation.

3. Government Guidance

Along with the above duty, the Government issued guidance which came into force on 31 March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that:

1. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

2. It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Minimum Revenue Provision Policy Statement 2011/12

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2007/2008, and assessed MRP for 2007/2008 onwards in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

In setting the Minimum Revenue Provision Policy, Medway Council has regard to the guidance and will set a policy to ensure a prudent provision for the repayment of debt.

The major proportion of the MRP for 2011/12 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 1 of the guidance.

Certain expenditure reflected within the debt liability at 31 March 2011 will, under delegated powers be subject to MRP under option 3, which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method (or annuity method if appropriate). For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

The Council will treat all expenditures as not ranking for MRP until the year after the scheme or asset to which they relate is completed and/or brought into use, rather than confine this approach solely to expenditures treated for MRP purposes under Option 3

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

In the case of long term debtors arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements (such as long term investments), or where borrowing has occurred but will be repaid by future Capital Receipts or agreed income from other source, there will be no Minimum Revenue Provision made.

Interest Rate Forecasts

The data below shows a variety of forecasts published by a number of institutions. The first three are individual forecasts including those of UBS and Capital Economics (an independent forecasting consultancy). The final one represents summarised figures drawn from the population of all major City banks and academic institutions.

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. Individual Forecasts

Sector: interest rate forecast – 6.1.11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%	2.75%	3.00%	3.25%	3.25%
3 month LIBID	0.60%	0.70%	0.80%	1.00%	1.25%	1.50%	1.75%	2.00%	2.50%	3.00%	3.25%	3.50%	3.50%
6 month LIBID	0.90%	1.00%	1.10%	1.20%	1.50%	1.80%	2.10%	2.40%	2.80%	3.20%	3.50%	3.80%	4.00%
12 month LIBID	1.40%	1.50%	1.60%	1.80%	2.10%	2.40%	2.70%	3.00%	3.20%	3.40%	3.65%	4.00%	4.20%
5yr PWLB rate	3.30%	3.30%	3.40%	3.50%	3.60%	3.80%	3.90%	4.10%	4.30%	4.60%	4.80%	4.90%	5.00%
10yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%	5.40%	5.40%
25yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%	5.70%
50yr PWLB rate	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%	5.70%

Capital Economics: interest rate forecast – 12.1.11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.00%
5yr PWLB rate	3.20%	3.20%	3.00%	2.75%	2.75%	2.90%	3.00%	3.20%	3.40%	3.60%	3.90%	4.20%
10yr PWLB rate	4.75%	4.75%	4.25%	3.75%	3.75%	3.75%	3.75%	3.75%	3.90%	4.00%	4.30%	4.60%
25yr PWLB rate	5.25%	5.25%	4.85%	4.65%	4.65%	4.65%	4.65%	4.65%	4.75%	4.85%	5.10%	5.30%
50yr PWLB rate	5.30%	5.30%	5.20%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.10%	5.20%	5.30%

UBS: interest rate forecast (for quarter ends) – 6.1.11

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
Bank rate	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.00%
10yr PWLB rate	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%
25yr PWLB rate	5.25%	5.30%	5.35%	5.40%	5.45%	5.50%	5.55%	5.60%
50yr PWLB rate	5.35%	5.40%	5.45%	5.50%	5.55%	5.60%	5.65%	5.70%

2. Survey of Economic Forecasts

HM Treasury December 2010

The current Q4 2010 and 2011 forecasts are based on the December 2010 report. Forecasts for 2010 – 2014 are based on 32 forecasts in the last quarterly forecast – in November 2010.

BANK RATE FORECASTS		quarter ended		annual average Bank Rate			
	actual	Q4 2011		ave. 2011	ave. 2012	ave. 2013	ave. 2014
Median	0.50%	2.00%		0.90%	1.60%	2.40%	3.00%
Highest	0.50%	0.50%		2.10%	3.10%	3.60%	4.50%
Lowest	0.50%	0.80%		0.50%	0.50%	0.60%	1.20%

Prudential and Treasury Indicators

TABLE 3: PRUDENTIAL INDICATORS	2011/2012	2012/2013	2013/2014
Extract from budget and rent setting report	**estimate**	**estimate**	**estimate**
	£'000	**£'000**	**£'000**
Capital Expenditure			
Non - HRA	48,923	12,452	3,854
HRA (applies only to housing authorities)	5,572	6,705	5,060
TOTAL	54,495	19,157	8,914
Ratio of financing costs to net revenue stream			
Non - HRA	2.96%	2.82%	2.40%
HRA (applies only to housing authorities)	14.39%	13.92%	20.46%
Net borrowing requirement			
brought forward 1 April	93,013	89,032	128,204
carried forward 31 March	89,032	128,204	123,541
in year borrowing requirement	-3,980	39,172	-4,663
Capital Financing Requirement as at 31 March			
Non – HRA	209,543	201,845	195,464
HRA	22,013	33,013	33,013
TOTAL	231,556	234,858	228,477
Annual change in Cap. Financing Requirement			
Non – HRA	-165	-7,698	-6,381
HRA	735	11,000	0
TOTAL	570	3,302	-6,381
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	-9.46	-18.69	-8.37
Increase in average housing rent per week	1.35	3.14	2.46

TABLE 4: TREASURY MANAGEMENT INDICATORS	2011/2012	2012/2013	2013/2014
	estimate	estimate	estimate
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	414,212	415,644	406,425
other long term liabilities	8	8	8
TOTAL	414,220	415,652	406,433
Operational Boundary for external debt -			
borrowing	376,556	377,858	369,477
other long term liabilities	8	8	8
TOTAL	376,564	377,866	369,485
Actual external debt	163,325	153,312	143,312
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	100%	100%	100%
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments	40%	40%	40%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£150,000	£150,000	£150,000

TABLE 5: Maturity structure of fixed rate borrowing during 2011/2012	upper limit	lower limit
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

Economic Background

Economic Background

4.1. Global economy

The sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May. A second crisis, this time over Ireland in November, culminated in Ireland also having to take a bail out. At the time of writing (early January 2011) there is major concern that Portugal will also shortly need to take a bail out. That, in turn, would then stoke major concerns as to whether the current size of the bail out facility put together by the EU and IMF would be big enough to cope with any crisis that then blew up over Spanish government debt.

The unexpectedly high rate of growth in quarters 2 and 3 of 2010 in the UK and the Euro zone in Q2 were driven by strong growth in the construction sector catching up from inclement weather earlier in the year and by other short term factors not expected to be enduring; general expectations are for anaemic (but not negative) growth in 2011 in the western world.

4.2 UK economy

Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The result of fiscal contraction will be major job losses during this period, in particular in public sector services. This is likely to have a knock on effect on consumer and business confidence and appears to have also hit the housing market as house prices started on a generally negative trend starting in mid 2010. Mortgage approvals are also at very weak levels, all of which indicates that the housing market is likely to be weak in 2011.

Economic Growth – GDP growth is likely to have peaked in the current period of recovery at 1.2% in quarter 2 of 2010. Growth in quarter 3 @ +0.7% was also unexpectedly high. However, the outlook is for anaemic growth in 2011/12 although the Bank of England and the Office for Budget Responsibility are forecasting near trend growth (2.5%) i.e. above what most forecasters are currently expecting.

Unemployment – the trend of falling unemployment (on the benefit claimant count) has now been replaced since July 2010 with small increases which may be the start of a new trend for some years ahead of rising unemployment.

Inflation and Bank Rate – CPI has remained high during 2010. It peaked at 3.7% in April and then gradually declined to 3.1% in September (RPI 4.6%). However, the outlook from there is a rising trend which could even reach as much as 4% in early 2011 before starting to subside again. Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years.

The Bank of England finished its programme of quantitative easing (QE) with a total of £200bn in November 2009. However, major expectation that there could be a second round of quantitative easing in late 2010 or early 2011, to help support economic growth, has evaporated after the surprises of the Q3 GDP figure of +0.7% and the November Inflation Report revising the forecast for short term inflation sharply upwards.

Sector's central view is that there is unlikely to be any increase in Bank Rate until the end of 2011.

AAA rating – prior to the general election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, then the AAA sovereign rating was at significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's budget on 22 June, Sterling strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors viewed UK government gilts as being a safe haven from EU government debt during mid 2010. The consequent increase in demand for gilts helped to add downward pressure on gilt yields and PWLB rates.

4.3 Sector's forward view

It is currently difficult to have confidence as to exactly how strong UK economic growth is likely to be during 2011/2012, and there are a range of views in the market. Sector has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- the strength / weakness of economic growth in our major trading partners - the US and EU
- the danger of currency war and resort to protectionism and tariff barriers if China does not adequately address the issue of its huge trade surplus due to its undervalued currency
- the degree to which government austerity programmes will dampen economic growth and undermine consumer confidence
- changes in the consumer savings ratio
- the speed of rebalancing of the UK economy towards exporting and substituting imports
- the potential, in the US, for more quantitative easing, and the timing of this , and its subsequent reversal in both the US and UK
- the speed of recovery of banks' profitability and balance sheet imbalances and the consequent implications for the availability of credit to borrowers
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy
- political risks in the Middle East and Korea

The overall balance of risks is weighted to the downside and there is some residual risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Specified and Non-Specified Investments

SPECIFIED INVESTMENTS:

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	* Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house and Fund Manager
Term deposits – local authorities	--	In-house and Fund Manager
Term deposits – banks and building societies **	See note 1 and 2	In-house and Fund Manager
Banks nationalised by high credit rated (sovereign rating) countries	See note 1 and 2	In-house and Fund Manager
Government guarantee (explicit) on ALL deposits by high credit rated (sovereign rating) countries**	See note 1 and 2	In-house and Fund Manager
UK Government support to the banking sector (implicit guarantee) ***	See note 1 and 2	In-house and Fund Manager
Collateralised deposit (see note 3)	UK sovereign rating	In-house and Fund Manager
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See note 1	In-house
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See Note 2	Fund Manager
Certificates of deposit issued by banks and building societies covered by the UK government banking support package (implicit guarantee)	See note 1	In-house
Certificates of deposit issued by banks and building societies covered by the UK government banking support package (implicit guarantee)	See Note 2	Fund Manager
Certificates of deposit issued by banks and building societies NOT covered by UK Government support package (implicit guarantee)	See note 1	In-house
Certificates of deposit issued by banks and building societies NOT covered by UK Government guarantee support package (implicit guarantee)	See Note 2	Fund Manager
UK Government Gilts	UK sovereign rating	In-house buy and hold and Fund Manager
Bonds issued by multilateral development banks	AAA	In-house buy and hold and Fund Manager
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	In-house buy and hold and Fund Manager
Sovereign bond issues (other than the UK govt)	AAA	In-house buy and hold and Fund Manager
Treasury Bills	UK sovereign rating	In house and Fund Manager
Government Liquidity Funds	* Long-term AAA volatility rating V1+	In-house and Fund Managers
Money Market Funds	* Long-term AAA volatility rating V1+	In-house and Fund Managers

Note 1. Award of "Creditworthiness" Colour by Sector Treasury services as detailed in paragraph 13.2 and appendix 10 TMP 1.1

Note 2. Inclusion within the Investec approved Counterparty list as detailed in paragraph 13.2 and appendix 10 TMP 1.1

** e.g. Australia (AA+), Singapore (AAA), Hong Kong (AA); need to specify list of countries approved for investing with their banks

***The original list of banks covered when the support package was initially announced was: -

- Abbey (now part of Santander)
- Barclays
- HBOS (now part of the Lloyds Group)
- Lloyds TSB
- HSBC
- Nationwide Building Society
- RBS
- Standard Chartered

Banks eligible for support under the UK bail-out package and which have issued debt guaranteed by the Government are eligible for a continuing Government guarantee when debt issues originally issued and guaranteed by the Government mature and are refinanced. However, no other institutions can make use of this support as it closed to new issues and entrants on 28.2.10. The banks which have used this explicit guarantee are as follows: -

- Bank of Scotland
- Barclays
- Clydesdale
- Coventry Building Society
- Investec Bank
- Nationwide Building Society
- Rothschild Continuation Finance plc
- Standard Life Bank
- Tesco Personal Finance plc
- Royal Bank of Scotland
- West Bromwich Building Society
- Yorkshire Building Society

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: A maximum of 70% ** will be held in aggregate in non-specified investment

1. Maturities of ANY period

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: -Structured deposits	See note 1	In-house	£10m	Lower of 5 years or Sector duration rating

2. Maturities in excess of 1 year

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Term deposits – local authorities	--	In-house	40%	5 Years
Term deposits – banks and building societies	See note 1	In-house	40%	As per Sector duration rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See note 1 and 2	In-house and Fund manager	40%	As per Sector duration rating and see note 3
Certificates of deposit issued by banks and building societies covered by the UK government banking support package (implicit guarantee)	See note 1 and 2	In-house and Fund manager	40%	As per Sector duration rating and see note 3
Certificates of deposit issued by banks and building societies NOT covered by UK Government support package (implicit guarantee)	See note 1 and 2	In-house and Fund manager	40%	As per Sector duration rating and see note 3
UK Government Gilts	UK sovereign rating	In-house and Fund Manager	40% In-house 100% Investec	In-house see note 1, Investec see note 2
Bonds issued by multilateral development banks	AAA	In-house and Fund Manager	20% in-house 40% Investec	In-house see note 1, Investec see note 2
Sovereign bond issues (other than the UK govt)	AAA	In-house and Fund Manager	20% in-house 40% Investec	In-house see note 1, Investec see note 2

Note 1. Award of "Creditworthiness" Colour by Sector Treasury services as detailed in paragraph 13.2 and appendix 10 TMP 1.1

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.
N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.

Note 2, Inclusion within the Investec approved Counterparty list as detailed in Section 13.2 and appendix 10 TMP 1.1

Note 3, Investec limits – Portfolio average to be up to 3 years, individual investments to a maximum of 10 years.

APPENDIX 6

Approved countries for investments

AAA

- Canada
- Denmark
- Finland
- France
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.
- U.S.A.

AA+

- Australia
- Belgium
- Hong Kong

AA

- Japan
- Kuwait
- Qatar (AA S&P rating)
- UAE

AA-

- Italy
- Saudi Arabia

TREASURY MANAGEMENT PRACTICES

January 2011

Contents

1 TMP1 RISK MANAGEMENT

The responsible officer 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 schedule to this document.

1.1 CREDIT AND COUNTERPARTY RISK MANAGEMENT

Credit and counter-party risk is the risk of failure by a counterparty to meet its contractual obligations to the organisation under an investment, borrowing, capital project or partnership financing, particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources.

This organisation 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 whom 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.

1.1.1 Policy on the use of credit risk analysis techniques

1. The Council will use credit criteria in order to select creditworthy counterparties for placing investments with.
2. Credit ratings will be used as supplied from all three rating agencies - Fitch, Moodys and Standard & Poors
3. Treasury Management Consultants will provide regular updates of changes to all ratings relevant to the council.
4. The responsible officer will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising maturity periods, type, group, sector, country and counterparty limits.

This organisation will use the Sector creditworthiness service based on using colours determined by minimum combinations of ratings to derive maturity limits as follows: -

- green – 3 months
- red – 6 months
- orange – 1 year
- blue – 1 year (applies to nationalised or semi nationalised UK banks)
- purple – 2 years
- yellow – 5 years

In addition a credit default swap overlay is used as a further safeguard to give early warning of potential creditworthiness problems which may only belatedly lead to actual changes in credit ratings.

As this methodology is complex, readers are referred to the document produced by Sector "Guide to Establishing Credit Policies April 2009" for a full explanation.

5. Credit ratings for individual counterparties can change at any time. The Finance Support Manager is responsible for applying approved credit rating criteria for selecting approved counterparties. Treasury management staff will add or delete counterparties to/from the approved counterparty list in line with the policy on criteria for selection of counterparties.

6. This organisation will not rely solely on credit ratings in order to select and monitor the creditworthiness of counterparties. In addition to credit ratings it will therefore use other sources of information including: -
    - The quality financial press
    - Market data
    - Information on government support for banks and
    - The credit ratings of that government support

7. Maximum maturity periods and amounts to be placed in different types of investment instrument are specified in paragraph 8 and TMP 1 schedule 1

8. Diversification: this organisation will avoid concentrations of lending and borrowing by adopting a policy of diversification. It will therefore use the following: -
    - Maximum amount to be placed with any one institution - £25m and for those with a sector duration of less than 12 months £20m.
    - Group limits where a number of institutions are under one ownership – maximum of £25m and for those with a sector duration of less than 12 months £20m.
    - Country limits – a minimum sovereign rating of AA- from Fitch Ratings is required for an institution to be placed on our approved lending list, maximum investment in any one country is £40m with the exception of UK which is unlimited. The list of countries which currently meet this criteria is: -

AAA	**AA+**	**AA**	**AA-**
Canada	Australia	Hong Kong	Italy
Denmark	Belgium	Japan	Saudi Arabia
Finland		Kuwait	
France		Qatar	
Germany		UAE	
Luxembourg			
Netherlands			
Norway			
Singapore			
Sweden			
Switzerland			
U.K.			
U.S.A.			

9. Investments will not be made with counterparties that do not have a credit rating in their own right

10. The definition of **'high credit quality' **** in order to determine what are specified investments as opposed to non specified investments which do not have high credit ratings is set out at the end of TMP1 in schedule 1. This schedule also sets out the categories of investment instruments which fall into the specified investments category as they entail **minimum procedural formalities** in terms of the placing of those investments by the treasury management team. Minimal procedural formalities means that the team is well experienced and knowledgeable in using these types of instruments and they pose minimal risk in their use.

11. The Council's external fund manager(s) will adhere to the counterparty credit criteria and maximum individual limits set by the Council; however the fund manager(s) may use a subset of the counterparty list so derived.

12. The counterparty list for the in-house team is available for members if required but is not published in this document due to the sensitive nature of this information

Funds invested with Fund Managers

The investment portfolio, which is invested with fund managers, must comply with the Treasury Strategy. In order to manage credit and counterparty risk management the current fund manager also uses a monitoring tool, which incorporates credit ratings, CDS data as well as market information.

The minimum credit criteria to be used by the cash fund manager(s) are as follows: -

	Fitch
Long Term	AA-
Short Term	F1+
Individual/Financial Strength	C
Support	1

Investec also have regard to Standard and Poor's ratings which are monitored by Bloomberg and updated manually on a regular basis.

a. Procedure for adding names to the Lending List
For a borrower to be considered for entry onto the lending list it should first meet the minimum credit rating. Once this condition has been met, the sponsor, be it dealer or fund manager, should communicate with the fixed income credit team and request the borrower's inclusion. If the credit team after their due diligence are comfortable for the name to be added to the list, a brief proposal should be written and presented at the next Risk Committee meeting. If the Risk Committee approves of the new borrower, Vendor Management should update the lending list, communicate this to the dealers and fund manager.

b. Monitoring the Lending List on an ongoing basis
The lending list will be formally reviewed by the Fixed Income Credit Team on a monthly basis and on an ongoing basis by the Fixed Income Rate Team.

c. Procedure for deleting names from the Lending List

If a name on the list is downgraded below any of the above ratings it will be immediately deleted from the list. Any other name can be deleted if the Credit Team believes the borrower is likely to be downgraded. If a borrower is removed from the lending list, any existing deposits or certificates of deposit can be run to maturity provided the client and credit team are happy to do so. Otherwise the investment will be sold at the first available opportunity.

d. Monitoring client compliance with the Lending List
We only lend to the counterparties on our Standard Lending List even if the client provides Investec with a broader lending list. This ensures the team is monitoring all the banks we feel comfortable with properly. The client's individual limits to banks are set up in Thinkfolio, an automated system for checking counterparty limits every time we deal. Any changes to counterparty limits need to be communicated to Vendor Management ASAP so that the changes can be made to Thinkfolio.

e. Credit Default Swap levels (CDS's)
CDS's for our counterparties are monitored on a daily basis from data provided by Bloomberg. The CDS market has both a speculative and bank credit worthiness (insurance) element. The mix between these two elements is not yet transparent and thus a judgment is called for as to the usefulness of CDS as a monitoring tool.

Our approach is to monitor the trends in CDS's for all the banks on the standard lending list over a year to date, one year, one month, one week and daily basis. Any concerning trends will result in the bank being excluded from longer term lending or in rare circumstances suspended from future investing and/or existing assets sold.

f. Subjective Overlay
The Fund Managers "score" the markets current attitude to our counterparties on the standard lending list. A low score (minimum 1) reflects strength and a high score (maximum 5) reflects a more negative view. Three characteristics of a banks trading patterns are evaluated and thus the total score range is 3 -15. The lower the score –the longer the maturity we would be prepared to take for a qualifying counterparty on our standard lending list. A high score will limit the maturity level.

Scores are given for the following three important tests:
Will a bank buy back its own certificates of deposits (CDs) from us?
If the answer is "Yes" this is seen as a signal that there is satisfactory liquidity and a low score will result. A "No" will lead to a high score to reflect the more restricted liquidity and the need to use the secondary market in order to dispose of a holding.

Is the bank a frequent or rare issuer of CDs?
Frequent issuers are likely to be less attractive in the secondary market (e.g. investment houses "may be full of the name" or the issuing bank may be viewed as having an above average need for new funding). Rare issuers will be more highly regarded.

Do CDs issued by the banks trade "well" in the secondary market?
The market's appetite for CDs is seen as a signal about credit concerns or otherwise for any bank.

13. Maximum maturity periods and amounts to be placed in different types of investment instrument are specified in paragraph 14 and TMP 1 schedule 1

14. Diversification: this organisation will avoid concentrations of lending and borrowing by adopting a policy of diversification. It will therefore use the following: -

- Maximum amount to be placed with any one institution – 20% of the total sum of managed portfolio.
- Group limits where a number of institutions are under one ownership – 20% of the total sum of managed portfolio.
- Country limits – a minimum sovereign rating of AA- from Fitch Ratings is required for an institution to be placed on our approved lending list, maximum investment in any one country is £40m with the exception of UK which is unlimited. The list of countries which currently meet this criteria is: -

AAA	**AA+**	**AA**	**AA-**
Canada	Australia	Hong Kong	Italy
Denmark	Belgium	Japan	Saudi Arabia
Finland		Kuwait	
France		Qatar	
Germany		UAE	
Luxembourg			
Netherlands			
Norway			
Singapore			
Sweden			
Switzerland			
U.K.			
U.S.A.			

15. Investments will not be made with counterparties that do not have a credit rating in their own right
16. The definition of **'high credit quality' **** in order to determine what are specified investments as opposed to non specified investments which do not have high credit ratings is set out at the end of TMP1 in schedule 1. This schedule also sets out the categories of investment instruments which fall into the specified investments category as they entail **minimum procedural formalities** in terms of the placing of those investments by the treasury management team. Minimal procedural formalities means that the team is well experienced and knowledgeable in using these types of instruments and they pose minimal risk in their use.
17. The counterparty last for Investec is available for members if required but is not published in this document due to the sensitive nature of this information

1.2 LIQUIDITY RISK MANAGEMENT

This is the risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's business/service objectives will be thereby compromised.

This organisation 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.

1.2.1 Amounts of approved minimum cash balances and short-term investments

The Treasury Management section shall seek to minimise the balance held in the Council's main bank accounts at the close of each working day with a guide balance of no more than £300,000 overdrawn or in credit.

1.2.2 Details of:

a. Standby facilities
The bank allows a £2m overdraft facility on the group accounts. Surplus funds are held on the daily account and are currently not swept into an interest bearing account as the interest bearing account is currently at its limit. If funds are received after the Treasury Management Section has completed its deals for the day the section will attempt to deposit funds in an account, which is available if it is within the permitted time frame.
b. Bank overdraft arrangements
A £2m overdraft at 1% over base rate has been agreed as part of the banking services contract. The overdraft is assessed on a group basis for the Council's accounts.
c. Short-term borrowing facilities
The Council accesses temporary loans through approved brokers on the London money market.
d. Insurance/guarantee facilities
There are no specific insurance or guarantee facilities as the above arrangements are regarded as being adequate to cover all unforeseen occurrences.
e. Special payments
24 hours notice must be given to the Treasury Team for all special payments (CHAPS) above £100,000.

1.3 INTEREST RATE RISK MANAGEMENT

The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.

This organisation 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 this by the prudent use of its approved financing and investment 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. This should be the subject to the consideration and, if required, approval of any policy or budgetary implications.

1.3.1 Details of approved interest rate exposure limits

the overall borrowing limit 2011-12	£414,220,000
the percentage of the overall borrowing portfolio which may be outstanding by way of short term borrowing	50%

1.3.2 Trigger points and other guidelines for managing changes to interest rate levels

The Chief Finance officer is responsible for incorporating the limits identified in 1.3.1 and 1.3.3 into the Annual Treasury Management Strategy, and for ensuring compliance with the limits.

The Treasury Management Section monitors interest rates very closely on a daily basis and any significant alterations would be reported immediately. Interest rates affect all decisions made on borrowing and investments.

1.3.3 Upper limit for variable interest rate exposure

Upper limit for variable interest rate exposure	40%

1.3.4 Upper limit for fixed interest rate exposure

Upper limit for fixed interest rate exposure	100%

1.3.5 Policies concerning the use of instruments for interest rate management

a. Forward dealing
   Consideration will be given to dealing from forward periods dependant upon market conditions. When forward dealing is more than 24 hours forward then the approval of the Finance Support Manager or Principal Accountant is required.

b. Callable deposits
   The Council will use callable deposits as part as of its Annual Treasury Strategy statement. The credit criteria and maximum periods are set out in the Schedule of Specified and Non Specified Investments appended to the Annual Treasury Strategy statement.

c. LOBOS (borrowing under lender's option/borrower's option)
   Use of LOBOs are considered as part of the annual borrowing strategy. The Chief Finance Officer must approve all borrowing for periods in excess of 364 days.

1.4 EXCHANGE RATE RISK MANAGEMENT

The risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.

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

1.4.1 Approved criteria for managing changes in exchange rate levels

a. As a result of the nature of Medway Council's business, Medway Council may have an exposure to exchange rate risk from time to time. This will mainly arise from the receipt of income or the incurring of expenditure in a currency other than sterling. Medway Council will adopt a full hedging strategy to control and add certainty to the sterling value of these transactions. This will mean that the council will eliminate all foreign exchange exposures as soon as they are identified.

b. Where there is a contractual obligation to receive income or make a payment in a currency other than sterling at a date in the future, forward foreign exchange transactions will be considered, with professional advice, to comply with this full cover hedging policy. Unexpected receipt of foreign currency income will be converted to sterling at the earliest opportunity unless Medway Council has a contractual obligation to make a payment in the same currency at a date in the future. In this instance, the currency will be held on deposit to meet this expenditure commitment.

1.5 REFINANCING RISK MANAGEMENT

The risk that maturing borrowings, capital, project or partnership financings cannot be refinanced on terms that reflect the provisions made by the organisation for those refinancing, both capital and current (revenue), and/or that the terms are inconsistent with prevailing market conditions at the time.

This organisation 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 overreliance on any one source of funding if this might jeopardise achievement of the above.
Refinancing risk is the risk that when loans or other forms of capital financing mature, that they cannot be refinanced where necessary on terms that reflect the assumptions made in formulating revenue and capital budgets.

1.5.1 Debt/other capital financing, maturity profiling, policies and practices

The Council will establish through its Prudential and Treasury Indicators the amount of debt maturing in any year/period.

Any debt rescheduling will be considered when the difference between the refinancing rate and the redemption rate is most advantageous and the situation will be continually monitored in order to take advantage of any perceived anomalies in the yield curve. The reasons for any rescheduling to take place will include:

a. the generation of cash savings at minimum risk;
b. to reduce the average interest rate;
c. to amend the maturity profile and /or the balance of volatility of the debt portfolio.

Rescheduling will be reported to full Council in the Annual Treasury Outturn Report.

1.5.2 Projected capital investment requirements

The responsible Officer will prepare a three-year plan for capital expenditure for the Council. The capital plan will be used to prepare a three-year revenue budget for all forms of financing charges. This will include using prudential borrowing to fund invest to save schemes.

Under the new capital financing system, the definition of capital expenditure and long term liabilities used in the Code will follow recommended accounting practice (SORP).

1.5.3 Policy concerning limits on affordability and revenue consequences of capital financing

In considering the affordability of its capital plans, the Council will consider all the resources currently available/estimated for the future together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the two following years and the impact these will have on council tax and housing rent levels. It will also take into account affordability in the longer term beyond this three year period.

The Council will use the definitions provided in the Prudential Code for borrowing (64), capital expenditure (65), capital financing requirement (67), debt (67), financing costs (68), investments (69), net borrowing (70), net revenue stream (71), other long term liabilities (72).

1.5.4 Capital receipts generated by the HRA

75% of capital receipts generated by RTB and other dwelling sales will be pooled together with 50% of capital receipts from the sale of land without buildings (net of capital allowances), i.e. paid to the Secretary of State, with the exception of 'qualifying disposals' (e.g. large and small scale voluntary transfers of housing to social registered landlords).

1.5.5 PFI, Partnerships, ALMOs and guarantees

This is currently not applicable to Medway Council.

1.6 LEGAL AND REGULATORY RISK MANAGEMENT

The risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

This organisation will ensure that all of 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.

This organisation recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation.

1.6.1 References to relevant statutes and regulations

The treasury management activities of the Council shall comply fully with legal statute, guidance, Codes of Practice and the regulations of the Council. These are:

- Local Government Act 2003
- S.I. 2003 No.2938 Local Government Act 2003 (Commencement No.1 and Transitional Provisions and Savings) Order 2003 13.11.03
- S.I. 2003 No.3146 Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and associated commentary 10.12.03
- S.I. 2004 No.533 Local Authorities (Capital Finance) (Consequential, Transitional and Savings Provisions) Order 2004 8.3.04
- S.I. 2004 No.534 Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2004 8.3.04
- Guidance on Investments ODPM 12.3.2004
- Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2006 Statutory Instrument No. 521
- S.I. 2007 no. 573 Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2007

- Local Government and Public Involvement in Health Act 2007 s238(2) – power to issue guidance; to be used re: MRP
- S.I. 2008 no. 414 f(Capital Finance and Accounting) (Amendment) (England) Regulations 2008
- S.I. 2009 no. 321 (Capital Finance and Accounting) (Amendment) (England) Regulations 2009
- S.I. 2009 no. 2272 The Local Authorities (Capital Finance And Accounting) (England) (Amendment) (No.2) Regulations 2009
- S.I. 2009 no. 3093 The Local Government Pension Fund Scheme (Management and Investment of Funds) Regulations 2009
- Guidance on Housing Capital Receipts Pooling ODPM 23.3.2004
- Requirement to set a balanced budget - Local Government Finance Act 1992 section 32 for billing authorities and section 43 for major precepting authorities.
- Local Government Finance Act 1988 section 114 – duty on the responsible officer to issue a report if the Council is likely to get into a financially unviable position.
- Allocation of financing costs to the HRA (housing authorities) – annual determination by Secretary of State
- Definition of HRA capital expenditure - Local Government and Housing Act 1989 section 74 (1)

- CIPFA's Treasury Management Codes of Practice and Guidance Notes 2009,
- CIPFA Prudential Code for Capital Finance in Local Authorities revised 2009
- CIPFA Guide for Chief Financial Officers on Treasury Management in Local Authorities 1996
- CIPFA Standard of Professional Practice on Treasury Management 2002
- CIPFA Standard of Professional Practice on Continuous professional Development 2005
- CIPFA Standard of Professional Practice on Ethics 2006
- The Good Governance Standard for Public Services 2004
- LAAP Bulletins
- SORP – Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of recommended Practice
- PWLB circulars on Lending Policy
- The Non Investment Products Code (NIPS) - (formerly known as The London Code of Conduct) for principals and broking firms in the wholesale markets.
- Financial Services Authority's Code of Market Conduct
- The Council's Standing Orders relating to Contracts
- The Council's Financial Regulations
- The Council's Scheme of Delegated Functions

1.6.2 Procedures for evidencing the council's powers/authorities to counterparties

The Council's powers to borrow and invest are contained in legislation.

- Investing: Local Government Act 2003, section 12
- Borrowing: Local Government Act 2003, section 1

Lending shall only be made to counterparties on the Approved Lending list. This list has been compiled using advice from the Council's treasury advisers based upon credit ratings supplied by Fitch, Moodys and Standard & Poors.

1.6.3 Statement on the council's political risks and management of same

The responsible officer shall take appropriate action with the Council, the Chief Executive and the Leader of the Council to respond to and manage appropriately political risks such as change of majority group, leadership in the Council, change of Government etc.

1.6.4 Monitoring Officer

The monitoring officer is the Assistant Director Housing and Corporate services; the duty of this officer is to ensure that the treasury management activities of the Council are lawful

1.6.5 Chief Finance officer

The Chief Finance Officer's duty is to ensure that the financial affairs of the Council are conducted in a prudent manner and to make a report to the Council if he has concerns as to the financial prudence of its actions or its expected financial position.

1.7 FRAUD, ERROR AND CORRUPTION, AND CONTINGENCY RISK MANAGEMENT

The risk that an organisation fails to identify the circumstances in which it may be exposed to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings, and fails to employ suitable systems and procedures and maintain effective contingency management arrangements to these ends. It includes the area of risk commonly referred to as operational risk.

This organisation 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.

The Council will therefore:-

a. seek to ensure an adequate division of responsibilities and maintenance at all times of an adequate level of internal check, which minimises such risks.
b. Fully document all its treasury management activities so that there can be no possible confusion as to what proper procedures are.
c. Staff will not be allowed to take up treasury management activities until they have had proper training in procedures and are then subject to an adequate and appropriate level of supervision.
d. Records will be maintained of all treasury management transactions so that there is a full audit trail and evidence of the appropriate checks being carried out.

1.7.1 Details of systems and procedures to be followed, including internet services

Procedures

Written procedures exist for completing the day-to-day treasury function, which is supported by the Treasury Strategy and Treasury Management Practices.

The daily treasury balances are obtained from Natwest bankline, the council's on-line banking system and all treasury payments are made using this system or the councils creditors system.

CHAPS/BACS payments are made via the on-line banking system – they are input by a treasury officer and approved by a finance service manager.

Investment and borrowing transactions

- A detailed register of all loans and investments is maintained.
- A written acknowledgement of each deal is sent promptly to the lending or borrowing institution where transactions are done directly with the organisation where that is a requirement of the institution being dealt with.
- Written confirmation is received and checked against the dealer's records for the transaction.
- Any discrepancies are immediately reported to the treasury and income team leader for resolution.
- All transactions placed through brokers are confirmed by a broker note showing details of the loan arranged. Written confirmation is received and checked against the dealer's records for the transaction. Any discrepancies are immediately reported to the treasury and income team leader for resolution.
- Contract notes for transactions carried out by the external fund managers will be received as executed and maintained.

Regularity and security

- Lending is only made to institutions on the Approved List of Counterparties.
- The treasury team enters into the treasury diary when money borrowed or lent is due to be repaid.
- All loans raised and repayments made go directly to and from the bank account of approved counterparties.
- Counterparty limits are set for every institution that the Council invests with.
- Brokers have a list of named officials authorised to agree deals.
- There is a separation of duties in the section between dealers and the checking and authorisation of all deals.
- The Council's bank holds a list of Council officials who are authorised signatories for treasury management transactions.
- No member of the treasury team is an authorised signatory.
- Payments can only be authorised using a proforma signed by an authorised signatory, the list of signatories having previously been agreed with the current provider of our banking services.
- There is adequate insurance cover for employees involved in loans management and accounting.
- Capital and interest withdrawals and capital injections in respect of monies managed by external fund managers can only be carried out in writing by the authorised signatories to the fund management agreement and notified to the fund manager(s).

Checks

- The bank reconciliation is carried out weekly for the housing benefit account and fortnightly for the general account and creditor account from the bank statement to the financial ledger.
- The bank statements are also checked for large transactions to ensure that they are valid transactions.
- The investment and borrowing spreadsheets are reconciled to the balance sheet ledger codes at the end of each month and at the financial year-end.
- A cost of borrowing and investment income earned is produced every month when a review is undertaken against the budget for interest earnings and debt costs.
- The valuations and investment income statements received monthly from the Council's fund managers will be checked and retained for audit inspection. The authority will ensure that the external funds we invest in, are accounted for in accordance with proper accounting practices.
- We have complied with the requirements of SORP (pre 1st April 2010 FRS 26) and IFRS Code (post 1st April 2010 IAS 39) and will account for the fund as Fair Value through Profit or

Loss. As a result, all gains and losses and interest (accrued and received) will be taken to the Income and Expenditure Account.

Calculations

- The calculation of repayment of principal and interest notified by the lender or borrower is checked for accuracy against the amount calculated on the relevant treasury paperwork.
- Periodic interest payments of PWLB and other long-term loans are reconciled and entered into the treasury diary. This is used to check the amount paid to lenders.
- Average equated capital loans fund interest rates are calculated monthly using information from PWLB and LOBO schedules. A reconciliation is carried out monthly between the financial ledger Integra and the PWLB and LOBO schedules.
- These interest and expense rates are then used to calculate the principal and interest charges to the General Fund and the Housing Revenue Account recharge.

1.7.2 Emergency and contingency planning arrangements

If personal computers are unavailable methods are in place for repaying loans, investing with counterparties, receiving repayments of investments and borrowing payments via fax and/or phone. Paper copies of the previous days treasury activity are always held and a paper-based diary is used for information on payments and repayments. The introduction of Internet based Bankline during 2008/09 has enabled remote access to make payments, transfers and check balances. All members of the treasury management team are familiar with this plan and new members will be briefed on it.

1.7.3 Insurance cover details

Fidelity insurance

The Council has ‘Fidelity’ insurance cover with Zurich Municipal. This covers the loss of cash by fraud or dishonesty of employees.
This cover is limited to £5m for any one event with an excess of £1m for any one event

Professional Indemnity Insurance

The Council also has a ‘Professional Indemnity’ insurance policy with Travelers Insurance Company, which covers loss to the Council from the actions and advice of its officers, which are negligent and without due care. This cover is limited to £5m for any one event with an excess of £100,000 for any one event.

Business Interruption

The Council also has a ‘Business Interruption’ cover as part of its property insurance with Zurich Municipal.

1.8 MARKET RISK MANAGEMENT

The risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

This organisation 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.

1.8.1 Details of approved procedures and limits for controlling exposure to investments whose capital value may fluctuate (Gilts, CDs etc)

These are controlled through setting limits on investment instruments where the principal value can fluctuate. The limits are determined and set through the Annual Treasury Management Strategy Statement.

TMP 1 SCHEDULE 1 – SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	* Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house and Fund Manager
Term deposits – local authorities	--	In-house and Fund Manager
Term deposits – banks and building societies **	See note 1 and 2	In-house and Fund Manager

Term deposits with nationalised banks and banks and building societies operating with government guarantees

	* Minimum Credit Criteria	Use
Banks nationalised by high credit rated (sovereign rating) countries	See note 1 and 2	In-house and Fund Managers
Government guarantee (explicit) on ALL deposits by high credit rated (sovereign rating) countries**	See note 1 and 2	In-house and Fund Managers
UK Government support to the banking sector (implicit guarantee) ***	See note 1 and 2	In-house and Fund Managers

Note 1. Award of "Creditworthiness" Colour by Sector Treasury services as detailed in paragraph 13.2 and appendix 10 TMP 1.1
Note 2. Inclusion within the Investec approved Counterparty list as detailed in paragraph 13.2 and appendix 10 TMP 1.1

Sector note: if clients wish to use a subsidiary of a parent bank and the subsidiary does not have a credit rating in its own right, then details of the guarantee from the parent should be added to this appendix. Sector suggests that clients should only rely on unconditional guarantees.

** e.g. Australia (AA+), Singapore (AAA), Hong Kong (AA); need to specify list of countries approved for investing with their banks

***The original list of banks covered when the support package was initially announced was: -

- Abbey (now part of Santander)
- Barclays
- HBOS (now part of the Lloyds Group)
- Lloyds TSB
- HSBC
- Nationwide Building Society
- RBS
- Standard Chartered

Banks eligible for support under the UK bail-out package and which have issued debt guaranteed by the Government are eligible for a continuing Government guarantee when debt issues originally issued and guaranteed by the Government mature and are refinanced. However, no other institutions can make use of this support as it closed to new issues and entrants on 28.2.10. The banks which have used this explicit guarantee are as follows: -

- Bank of Scotland
- Barclays
- Clydesdale
- Coventry Building Society
- Investec bank
- Nationwide Building Society
- Rothschild Continuation Finance plc
- Standard Life Bank
- Tesco Personal Finance plc
- Royal Bank of Scotland
- West Bromwich Building Society
- Yorkshire Building Society

Collateralised deposit (see note 3)	UK sovereign rating	In-house and Fund Manager
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See note 1	In-house
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See Note 2	Fund Manager
Certificates of deposit issued by banks and building societies covered by the UK government banking support package (implicit guarantee)	See note 1	In-house
Certificates of deposit issued by banks and building societies covered by the UK government banking support package (implicit guarantee)	See Note 2	Fund Manager
Certificates of deposit issued by banks and building societies NOT covered by UK Government support package (implicit guarantee)	See note 1	In-house

Certificates of deposit issued by banks and building societies NOT covered by UK Government guarantee support package (implicit guarantee)	See Note 2	Fund Manager
UK Government Gilts	UK sovereign rating	In-house buy and hold and Fund Manager
Bonds issued by multilateral development banks	AAA	In-house buy and hold and Fund Manager
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	In-house buy and hold and Fund Manager
Sovereign bond issues (other than the UK govt)	AAA	In-house buy and hold and Fund Manager
Treasury Bills	UK sovereign rating	In house and Fund Manager

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Government Liquidity Funds	* Long-term AAA volatility rating V1+	In-house and Fund Manager
2. Money Market Funds	* Long-term AAA volatility rating V1+	In-house and Fund Manager

Note 1. Award of "Creditworthiness" Colour by Sector Treasury services as detailed in paragraph 13.2 and appendix 10 TMP 1.1

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.
N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.

Note 2, Inclusion within the Investec approved Counterparty list as detailed in Section 13.2 and appendix 10 TMP 1.1

Note 3. as collateralised deposits are backed by collateral of AAA rated local authority LOBOs, this investment instrument is regarded as being a AAA rated investment as it is equivalent to lending to a local authority

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

1.8.2 NON-SPECIFIED INVESTMENTS:

A maximum of 70% ** will be held in aggregate in non-specified investment

1. Maturities of ANY period

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: - Structured deposits	See note 1	In-house	£10m	Lower of 5 years or Sector duration rating

Note 1. Award of “Creditworthiness” Colour by Sector Treasury services as detailed in paragraph 13.2 and appendix 10 TMP 1.1

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.
N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.

2. Maturities in excess of 1 year

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Term deposits – local authorities	--	In-house	40%	5 Years
Term deposits – banks and building societies	See note 1	In-house	40%	As per Sector duration rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See note 1	In-house	40%	As per Sector duration rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See note 2	Fund Manager	40%	See Note 3
Certificates of deposit issued by banks and building societies covered by the UK government banking support package (implicit guarantee)	See note 1	In-house	40%	As per Sector duration rating
Certificates of deposit issued by banks and building societies covered by the UK government banking support package (implicit guarantee)	See note 2	Fund Manager	40%	See Note 3

Certificates of deposit issued by banks and building societies NOT covered by UK Government support package (implicit guarantee)	See note 1	In-house	40%	As per Sector duration rating
Certificates of deposit issued by banks and building societies NOT covered by UK Government guarantee support package (implicit guarantee)	See note 2	Fund Manager	40%	See Note 3
UK Government Gilts	UK sovereign rating	In-house and Fund Manager	40% In-house 100% Investec	In-house see note 1, Investec see note 2
Bonds issued by multilateral development banks	AAA	In-house and Fund Manager	20% in-house 40% Investec	In-house see note 1, Investec see note 2
Sovereign bond issues (other than the UK govt)	AAA	In-house and Fund Manager	20% in-house 40% Investec	In-house see note 1, Investec see note 2

Note 1. Award of “Creditworthiness” Colour by Sector Treasury services as detailed in paragraph 13.2 and appendix 10 TMP 1.1

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.
N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.

Note 2, Inclusion within the Investec approved Counterparty list as detailed in Section 13.2 and appendix 10 TMP 1.1

Note 3, Investec limits – Portfolio average to be up to 3 years, individual investments to a maximum of 10 years.

2 TMP 2 PERFORMANCE MEASUREMENT

2.1 EVALUATION AND REVIEW OF TREASURY MANAGEMENT DECISIONS

The Council has a number of approaches to evaluating treasury management decisions:

For performance outcomes:

a. we will establish monthly review meetings with the treasury management team
b. reviews with our treasury management consultants
c. annual treasury outturn report as reported to full council
d. mid year review to full council
e. comparative reviews
f. strategic, scrutiny and efficiency, VFM reviews

2.1.1 Periodic reviews during the financial year

The Finance Support Manager, Principal Accountant and Treasury and Income Team Leader will introduce a monthly meeting to review actual activity against the Treasury Management Strategy Statement and cash flow forecasts.

This will include :

a. Total debt including average rate, actual rate and maturity profile
b. Total investments including average rate, actual rate and maturity profile

and changes to the above from the previous review and against the TMSS.

2.1.2 Reviews with our treasury management consultants

The treasury management team holds reviews with our consultants approximately every 4 months to review the performance of the investment and debt portfolios.

2.1.3 Annual Review after the end of the financial year

An Annual Treasury Outturn Report is submitted to the Council each year after the close of the financial year, which reviews the performance of the debt and investment portfolios. This report contains the following: -

a. total debt and investments at the beginning and close of the financial year and average interest rates
b. borrowing strategy for the year compared to actual strategy
c. investment strategy for the year compared to actual strategy
d. explanations for variance between original strategies and actual
e. debt rescheduling done in the year
f. actual borrowing and investment rates available through the year
g. comparison of return on investments to the investment benchmark
h. compliance with Prudential and Treasury Indicators
i. other

2.1.4 Comparative review and benchmarking

When data becomes available, comparative reviews are undertaken to see how the performance of the authority on debt and investments compares to other authorities with similar size portfolios (but allowing for the fact that Prudential and Treasury Indicators are locally set). Data used will be sourced from: -

- CIPFA Treasury Management statistics published each year for the last complete financial year
- CIPFA Benchmarking Club
- other

2.2 Benchmarks and Calculation Methodology

Medway Council is a member of Treasury Management and Debt Management Benchmarking Clubs, which are run by CIPFA.

Debt management

- Average rate on all external debt
- Average period to maturity of external debt

Investment

The performance of investment earnings will be measured against the following benchmarks: -

a. in house investments
Other local authorities
Other market products
Cash fund manager

b. cash fund manager
7 day Local Authority Deposit Rate
In-house treasury team

Performance will also be measured against other local authority funds with similar benchmark and parameters managed by other fund managers.

2.3 Policy Concerning Methods for Testing Value for money in Treasury Management

2.3.1 Treasury services will be procured in accordance with Council procurement rules that are set to establish value for money

3 TMP 3 DECISION-MAKING AND ANALYSIS

3.1 FUNDING, BORROWING, LENDING, AND NEW INSTRUMENTS/TECHNIQUES:

3.1.1 Records to be kept

The following records will be retained*:* -

- Daily cash balance forecasts
- Daily bank balances from Natwest bankline
- Investment limits & borrowing analysis
- Money market rates obtained by telephone from brokers
- Dealing sheet for all money market transactions
- Brokers' confirmations for investment and temporary borrowing transactions
- Confirmations from borrowing /lending institutions where deals are done directly
- PWLB loan confirmations
- PWLB debt portfolio schedules
- Certificates for market loans, local bonds and other loans
- Contract notes received from fund manager
- Fund manager valuation statements

3.1.2 Processes to be pursued

- Cash flow analysis
- Debt and investment maturity analysis
- Ledger reconciliation
- Review of opportunities for debt restructuring
- Review of borrowing requirement to finance capital expenditure (and other forms of financing where those offer best value)
- Performance information (e.g. monitoring of actuals against budget for debt charges, interest earned, investment returns, etc).

3.1.3 Issues to be addressed

3.1.3.1. In respect of every treasury management decision made the Council will:

a) Above all be clear about the nature and extent of the risks to which the Council may become exposed
b) Be certain about the legality of the decision reached and the nature of the transaction, and that all authorities to proceed have been obtained
c) Be content that the documentation is adequate both to deliver the Council's objectives and protect the Council's interests, and to deliver good housekeeping
d) Ensure that third parties are judged satisfactory in the context of the Council's creditworthiness policies, and that limits have not been exceeded
e) Be content that the terms of any transactions have been fully checked against the market, and have been found to be competitive.

3.1.3.2 In respect of borrowing and other funding decisions, the Council will:

a) consider the ongoing revenue liabilities created, and the implications for the organisation's future plans and budgets
b) evaluate the economic and market factors that might influence the manner and timing of any decision to fund
c) consider the merits and demerits of alternative forms of funding, including funding from revenue, leasing and private partnerships
d) consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use and, if relevant, the opportunities for foreign currency funding.

3.1.3.3 In respect of investment decisions, the Council will:

a) consider the optimum period, in the light of cash flow availability and prevailing market conditions;
b) consider the alternative investment products and techniques available, especially the implications of using any which may expose the Council to changes in the value of its capital.

4 TMP 4 APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

4.1 APPROVED ACTIVITIES OF THE TREASURY MANAGEMENT OPERATION

- borrowing;
- lending;
- debt repayment and rescheduling;
- consideration, approval and use of new financial instruments and treasury management techniques;
- managing the underlying risk associated with the Council's capital financing and surplus funds activities;
- managing cash flow;
- banking activities;
- the use of external fund managers (other than Pension Fund);
- leasing.

4.2 APPROVED INSTRUMENTS FOR INVESTMENTS

The latest version of the Treasury Management Strategy is appended to this document.

4.3 APPROVED TECHNIQUES

- Forward dealing
- LOBOs – lenders option, borrower's option borrowing instrument
- PWLB
- The use of structured products such as callable deposits

4.4 APPROVED METHODS AND SOURCES OF RAISING CAPITAL FINANCE

Finance will only be raised in accordance with the Local Government Act 2003, and within this limit the Council has a number of approved methods and sources of raising capital finance. These are:

On Balance Sheet	Fixed	Variable
PWLB	●	●
European Investment Bank	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Leasing (not operating leases)	●	●
Deferred Purchase	●	●

Other Methods of Financing
Government and EC Capital Grants
Lottery monies
PFI/PPP
Operating leases

Borrowing will only be done in Sterling. All forms of funding will be considered dependent on the prevailing economic climate, regulations and local considerations. The responsible officer has delegated powers in accordance with Financial Regulations, Standing Orders, the Scheme of Delegation to Officers Policy and the Treasury Management Strategy to take the most appropriate form of borrowing from the approved sources.

4.5 INVESTMENT LIMITS

The Treasury Management Strategy Statement sets out the limits and the guidelines for use of each type of investment instrument.

4.6 BORROWING LIMITS

The Treasury Management Strategy Statement details the Prudential and Treasury Indicators.

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

5.1 LIMITS TO RESPONSIBILITIES / DISCRETION AT COUNCIL/EXECUTIVE LEVELS

a) The full Council will set the Prudential Indicators and revise them as and when necessary.
b) The Business Support Overview and Scrutiny committee, Cabinet and then Full Council will receive and review reports on treasury management policies, the annual treasury management strategies and the mid year report.
c) The Business Support Overview and Scrutiny committee and Cabinet will receive and review Treasury Management Practices.
d) Cabinet and Audit Committee will receive and review the Annual Treasury Outturn report.
e) Cabinet will receive and review Treasury Management monitoring reports.
f) The Chief Finance Officer will be responsible for amendments to the Council's adopted clauses, treasury management policy statement and treasury management practices.
g) Cabinet will consider and approve the Treasury Management Budget.
h) The Business Support Overview and Scrutiny committee and Cabinet will approve the segregation of responsibilities via the TMP Schedules.
i) The Finance Support Manager will receive and review external audit reports and put recommendations to the Audit Committee.
j) Approving the selection of external service providers and agreeing terms of appointment will be decided by Cabinet in accordance with Financial Regulations.

5.2 PRINCIPLES AND PRACTICES CONCERNING SEGREGATION OF DUTIES

a) Approvals of payments on Natwest Bankline payments system are segregated from input of payments.
b) Treasury paperwork approval is segregated from approval of payments on Bankline.
c) A check is made by the approver on the validity of the deals and that all payments due are being made.

5.3 TREASURY MANAGEMENT ORGANISATION CHART

All decisions on borrowing, investing or financing are delegated by Medway Council to the Chief Finance Officer. Further delegation of responsibility is made by the Chief Finance Officer to his staff, who are all required to act in accordance with CIPFA's code on Treasury Management.

The structure for decision-making and delegation of responsibility for long-term borrowing is as follows: -

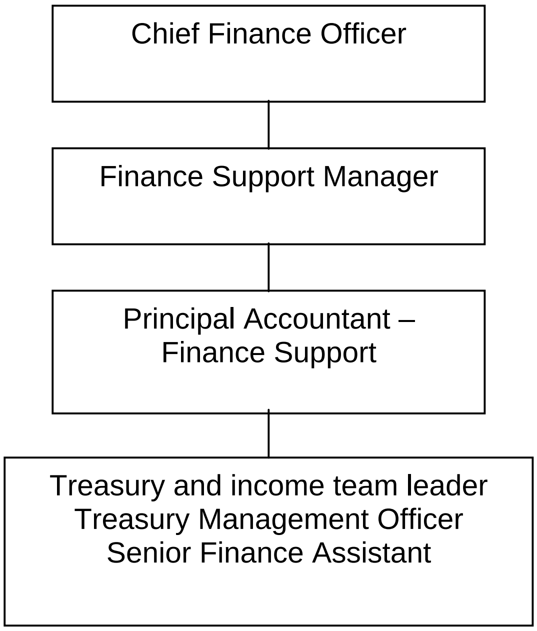
1. Strategy and decisions on borrowing and lending.

Chief Finance Officer

Finance Support Manager

It is the responsibility of the Finance Support Manager to prepare the annual strategy for approval by the Chief Finance Officer. In addition he will consider and decide on detailed proposals for borrowing and investment made by the Finance Support Manager.

2. Day to day cash flow management delegated to the Finance Support Manager and Treasury Team.



5.4 STATEMENT OF DUTIES/RESPONSIBILITIES OF EACH TREASURY POST

5.4.1 Chief Finance Officer

The Chief Finance Officer will:

a) Ensure that the treasury system is specified and implemented
b) Submit budgets and budget variations in accordance with Financial Regulations and guidance.
c) In setting the prudential indicators, the Chief Finance Officer will be responsible for ensuring that all matters are taken into account and reported to the Council so as to ensure the Council's financial plans are affordable, prudent and sustainable in the long term.
d) Establish a measurement and reporting process that highlights significant variations from expectations.
e) In extreme circumstances make reports to the Council under S114 of the Local Government Finance Act 1988 (Scotland – S95 of the Local Government (Scotland) Act 1973) if the Chief Finance Officer considers the Council is likely to get into a financially unviable situation.
f) Review the performance of the treasury management function and promote best value reviews.
g) Ensure the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.
h) Ensure the adequacy of internal audit, and liaising with external audit.
i) Recommend on appointment of external service providers in accordance with council standing orders.

1. The Chief Finance Officer has delegated powers through this policy to take the most appropriate form of borrowing from the approved sources, and to make the most appropriate form of investments in approved instruments.

2. The Chief Finance Officer may delegate his power to borrow and invest to members of his staff. The Finance Support Manager, the Principal Accountant Finance Support, the Treasury and Income Team Leader, the Treasury Management Officer or Senior Finance Assistant must conduct all dealing transactions, or staff authorised by the Chief Finance Officer to act as temporary cover for leave/sickness. All transactions must be authorised by an approver who did not conduct the dealing transaction.

3. The Chief Finance Officer will ensure that Treasury Management Policy is adhered to, and if not will bring the matter to the attention of elected members as soon as possible.

4. Prior to entering into any capital financing, lending or investment transaction, it is the responsibility of the Chief Finance Officer to be satisfied, by reference to the Council's legal department and external advisors as appropriate, that the proposed transaction does not breach any statute, external regulation or the Council's Financial Regulations

5. It is also the responsibility of the Chief Finance Officer to ensure that the Council complies with the requirements of The Non Investment Products Code (formerly known as The London Code of Conduct) for principals and broking firms in the wholesale markets.

5.4.2 Finance Support Manager – Treasury Manager

The responsibilities of this post will be: -

a) Recommend clauses, treasury management policy / practices for approval, reviewing the same on a regular basis, and monitoring compliance.
b) Submit treasury management reports as required to the Business Support Overview and Scrutiny committee and then to full Council.
c) Execution of transactions and conduct of other day-to-day activities in accordance with the Treasury Management Practices.
d) Adherence to agreed policies and limits.
e) Managing the overall treasury management function.
f) Supervising treasury management staff.
g) Ensuring appropriate segregation of duties
h) Monitoring performance on a day-to-day basis.
i) Submitting management information reports to the Chief Finance Officer.
j) Maintaining relationships with third parties and external service providers and reviewing their performance.

5.4.3 The Head of the Paid Service – the Chief Executive

The responsibilities of this post will be: -

a) Ensuring that the Chief Finance Officer reports as required to the Business Support Overview and Scrutiny committee, Cabinet and full Council on treasury policy, activity and performance.

5.4.4 The Monitoring Officer – the Head of Legal Services

The responsibilities of this post will be: -

a) Ensuring compliance by the Chief Finance Officer with the treasury management policy statement and treasury management practices and that they comply with the law.
b) Being satisfied that any proposal to vary treasury policy or practice complies with law or any code of practice.
c) Giving advice to the Chief Finance Officer when advice is sought.

5.4.5 Internal Audit

The responsibilities of Internal Audit will be: -

a) Reviewing compliance with approved policy and treasury management practices.
b) Reviewing division of duties and operational practice.
c) Assessing value for money from treasury activities.
d) Undertaking probity audit of treasury function.

5.5 ABSENCE COVER ARRANGEMENTS

At least 2 members of the Treasury Team are available at all times or emergency back up is available. There will be at least three members of staff confident in the undertaking of the daily Treasury activities within the team. There are 6 officers who may approve treasury transactions and a rota is set on a weekly basis to ensure that there are always at least 2 approvers available. Approvals can also be done remotely from any internet terminal.

5.6 DEALING LIMITS

- The dealer must adhere to the agreed lending list. This controls counterparty risk. The dealer is not restricted in who they may borrow from, here the risk is with the counterparty. However the dealer must be aware of the possibility that any counterparty may be "laundering money".

- Limits on those institutions that the dealer may lend to are set out in these Treasury Management Practices. There is a maximum limit to the deals that may be open with them at any one time. At present, the limits for authorised counterparties is between £10m and £20m depending upon rating for the in-house team or 20% of the Portfolio for Investec. There is also a country limit of £40m save for the UK where there is not a limit for the in-house treasury team. This ensures diversification and therefore decreases risk. This system of limits is discussed in schedule one of this document.

- All treasury management decisions undertaken must adhere to the framework and strategy set out in the Treasury Policy Statement and their schedules. Decisions must operate within limits set by statutory instruments, codes of practice and other regulatory criteria. The dealer must ensure that they are operating within their own limits to decision making as described in part 5.6 of this schedule. A dealer should not assume they have unlimited responsibility by being aware of the responsibilities of others as specified in 5.4.

5.7 LIST OF APPROVED BROKERS

A list of approved brokers is maintained within the Treasury Team and a record of all transactions recorded against them. See TMP 11.1.2.

5.8 POLICY ON BROKERS' SERVICES

It is the Council's policy to rotate business between brokers.

5.9 POLICY ON TAPING OF CONVERSATIONS

It is not the Council's policy to tape brokers conversations

5.10 DIRECT DEALING PRACTICES

The Council will consider dealing direct with counterparties if it is appropriate and the Council believes that better terms will be available. At present, most deals are arranged through direct deals for investments. There are certain types of accounts and facilities, where direct dealing is required, as follows;

- Business Reserve Accounts:
- Call Accounts:
- Money Market Funds.

5.11 SETTLEMENT TRANSMISSION PROCEDURES

Funds that are due to be paid to a named counterparty or payee are transmitted by electronic transfer using the NatWest Clearing House Automated Payments System (or CHAPS). This method allows the transfer of funds from Medway Council's bank accounts to a receiver's account, without need to inform the bank. Medway Council can also receive payments via CHAPS/BACS; the Medway General Account is the designated account for inward payments account no. 90502094 outward payments are made from account no. 90502108.

CHAPS/BACS instructions are entered by the dealer onto the internet Bankline system. Notification of incoming payments is by bank fax. Approved managers authorise and action the payments using a secure system. An audit trail is maintained on the internet Bankline system that shows what was approved, and by whom. Bankline generates a unique reference number for each payment by which it can be tracked and all information is held against.

The close of business daily is as follows: -

	Close of Business	Latest time for payment release
CHAPS	17:00	15:49 or 16:49 for Natwest accounts
BACS	17:00	18:15

There is no minimum threshold on how small a payment can be. There is however an upper limit on total payments made. The total payments may not exceed £10m; if this limit is likely to be breached contact must be made with Nat West informing them of this situation.

There are three levels of users for Bankline; input, approval and two administrators. The Finance Support section maintains a list within Bankline of which members of staff are authorised to access CHAPS/BACS. It also lists the various transactions they are authorised to carry out. In the event of the Bankline system failing instructions for CHAPS/BACS are faxed to Natwest. An authorised signatory countersigns this document.

The dealer enters payments via Bankline and verifies their accuracy, confirming details.

The approver is able to view the payment and approve the transmission of funds after checking the verified entry to the documentation supplied by the dealer. For security reasons no user can enter and then release payments.

The administrators can either enter or approve payments (but not both) as they are set up as "dual" administrators but both would have to approve material changes. They arrange the system privileges that are conferred upon specific users of the Bankline system.

5.12 DOCUMENTATION REQUIREMENTS

For each deal undertaken a record is prepared giving details of dealer, amount, period, counterparty, interest rate, dealing date, payment date(s), broker.

6 TMP6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGMENTS

6.1 ANNUAL PROGRAMME OF REPORTING

a) Annual reporting requirements before the start of the year: -
   - review of the organisation's approved clauses, treasury management policy statement and practices
   - strategy report on proposed treasury management activities for the year comprising of the Treasury management strategy statement, Annual Investment Strategy and Minimum Revenue Provision Policy Statement

b) Mid-year review
c) Annual review report after the end of the year

6.2 ANNUAL TREASURY MANAGEMENT STRATEGY STATEMENT

The Treasury Management Strategy Statement sets out the specific expected treasury activities for the forthcoming financial year. This strategy will be submitted Business Support Overview and Scrutiny committee, Cabinet and then to the full Council for approval before the commencement of each financial year.

The formulation of the annual Treasury Management Strategy Statement involves determining the appropriate borrowing and investment decisions in the light of the anticipated movement in both fixed and shorter -term variable interest rates. For instance, the Council may decide to postpone borrowing if fixed interest rates are expected to fall, or borrow early if fixed interest rates are expected to rise.

The Treasury Management Strategy Statement is concerned with the following elements:

- Prudential and Treasury Indicators
- the current treasury portfolio
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- the MRP strategy

The Treasury Management Strategy Statement will establish the expected move in interest rates against alternatives (using all available information such as published interest rate forecasts where applicable), and highlight sensitivities to different scenarios.

6.3 THE ANNUAL INVESTMENT STRATEGY STATEMENT

At the same time as the Council receives the Treasury Management Strategy Statement it will also receive a report on the Annual Investment Strategy which will set out the following: -

a) The Council's risk appetite in respect of security, liquidity and optimum performance
b) The definition of high credit quality to determine what are specified investments as distinct from non specified investments
c) Which specified and non specified instruments the Council will use
d) Whether they will be used by the in house team, external managers or both

e) The Council's policy on the use of credit ratings and other credit risk analysis techniques to determine creditworthy counterparties for its approved lending list
f) Which credit rating agencies the Council will use
g) How the Council will deal with changes in ratings, rating watches and rating outlooks
h) Limits for individual counterparties and group limits
i) Country limits
j) Levels of cash balances
k) Interest rate outlook
l) Budget for investment earnings
m) Use of a cash fund manager
n) Policy on the use of external service providers

6.4 THE ANNUAL MINIMUM REVENUE PROVISION STATEMENT

This statement will set out how the Council will make revenue provision for repayment of its borrowing using the four options for so doing and will be submitted at the same time as the Annual Treasury Management Strategy Statement.

6.5 POLICY ON PRUDENTIAL AND TREASURY INDICATORS

The Council approves before the beginning of each financial year a number of treasury limits which are set through Prudential and Treasury Indicators.

The responsible officer is responsible for incorporating these limits into the Annual Treasury Management Strategy Statement, and for ensuring compliance with the limits. Should it prove necessary to amend these limits, the responsible officer shall submit the changes for approval to the full Council

6.6 MID YEAR REVIEW

The Council will review its treasury management activities and strategy on a six monthly basis. This review will consider the following: -

a) activities undertaken
b) variations (if any) from agreed policies/practices
c) interim performance report
d) regular monitoring
e) monitoring of treasury management indicators for local authorities.

6.7 ANNUAL REPORT ON TREASURY MANAGEMENT ACTIVITY

An annual report will be presented to the Business Support Overview and Scrutiny committee and then to the full Council at the earliest practicable meeting after the end of the financial year, but in any case by the end of September. This report will include the following: -

a) transactions executed and their revenue (current) effects
b) report on risk implications of decisions taken and transactions executed
c) compliance report on agreed policies and practices, and on statutory/regulatory requirements
d) performance report
e) report on compliance with CIPFA Code recommendations
f) monitoring of treasury management indicators

6.8 MANAGEMENT INFORMATION REPORTS

Management information reports will be prepared every month by the Treasury and Income Team Leader and will be presented to the Principal Accountant.

These reports will contain the following information: -

a) A summary of transactions executed and reconciled;
b) degree of compliance with original strategy and explanation of variances.
c) Any non-compliance with Prudential limits or other treasury management limits.

7 TMP 7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

7.1 STATUTORY/REGULATORY REQUIREMENTS

The accounts are drawn up in accordance with the Code of Practice on Local Authority Accounting in Great Britain that is recognised by statute as representing proper accounting practices. The Council has also adopted in full the principles set out in CIPFA's 'Treasury Management in the Public Services - Code of Practice' (the 'CIPFA Code'), together with those of its specific recommendations that are relevant to this Council's treasury management activities.

7.2 ACCOUNTING PRACTICES AND STANDARDS

Due regard is given to the Statements of Recommended Practice and Accounting Standards as they apply to Local Authorities in Great Britain.

7.3 BUDGETS / ACCOUNTS / PRUDENTIAL INDICATORS

The Finance Support Manager will prepare a three-year medium term financial plan with Prudential Indicators for treasury management, which will incorporate the budget for the forthcoming year and provisional estimates for the following two years. This will bring together all the costs involved in running the function, together with associated income. The Finance Support Manager will exercise effective controls over this budget and monitoring of performance against Prudential Indicators, and will report upon and recommend any changes required in accordance with TMP6.

7.4 LIST OF INFORMATION REQUIREMENTS OF EXTERNAL AUDITORS

- Reconciliation of loans outstanding in the financial ledger to Treasury Management records
- Maturity analysis of loans outstanding
- Certificates for new long term loans taken out in the year
- Reconciliation of loan interest, discounts received and premiums paid to financial ledger by loan type
- Calculation of loans fund interest and debt management expenses
- Details of interest rates applied to internal investments
- Calculation of interest on working balances
- Interest accrual calculation
- Analysis of any deferred charges
- Calculation of loans fund creditors and debtors
- Annual Treasury Report
- Treasury Management Strategy Statement and Prudential Indicators
- Review of observance of limits set by Prudential Indicators
- Calculation of the Minimum Revenue Provision
- External fund manager(s) valuations including investment income schedules and movement in capital values.

7.4.1 Monthly Budget Monitoring Report

Monthly Budget Monitoring reports are produced for the Chief Finance Officer and DMT, whilst a bi-monthly budget monitoring report goes to Cabinet. The report is intended to highlight any variances between budgets and spend in order that the Council can assess its financial position. Details of treasury management activities are included within this report.

8 TMP 8 CASH AND CASH FLOW MANAGEMENT

8.1 ARRANGEMENTS FOR PREPARING/SUBMITTING CASH FLOW STATEMENTS

Cash flow projections are prepared annually, but are reviewed daily. The annual cash flow projections are prepared from the previous years' cash flow records, adjusted for known changes in levels of income and expenditure and also changes in payments and receipts dates. These details are supplemented on an ongoing basis by information received of new or revised amounts to be paid or received as and when they are known.

The framework for cash flow projection is set up on a spreadsheet a year in advance, projected forward for the whole of the following year. The model contains all sources of income and expenditure as they appear on the bank statements, grant schedules and creditor payments for previous periods. An estimate for movement on school balances and capital expenditure is also included. A summarised cash flow is produced forecasting cash balances for four years.

8.2 BANK STATEMENTS PROCEDURES

The Council receives daily bank statements and a daily download of data from its bank. All amounts on the statement are checked to source data from Payroll, Creditors etc.
The Control Team undertakes a formal bank reconciliation on a weekly basis for the Housing Benefit Account and fortnightly for the General Account and Creditors Account.

8.3 PAYMENT SCHEDULING AND AGREED TERMS OF TRADE WITH CREDITORS

Our policy is to pay creditors within 30 days of the invoice date and this effectively schedules the payments. Certificated payments to sub-contractors must be paid immediately where possible.

8.4 ARRANGEMENTS FOR MONITORING DEBTORS / CREDITORS LEVELS

The Finance Manager Exchequer is responsible for monitoring the levels of debtors and creditors. Details are passed to the treasury team on a daily basis to assist in updating the cash flow models.

8.5 PROCEDURES FOR BANKING OF FUNDS

All money received by an officer on behalf of the Council will without unreasonable delay be passed to the cashiers team to deposit in the Council's banking accounts.

8.6 PRACTICES CONCERNING PREPAYMENTS TO OBTAIN BENEFITS

The Council has no formal arrangement in place. Where such opportunities arise, the prepayment would be sought and authorised by the Finance Manager.

9 TMP 9 MONEY LAUNDERING

9.1 PROCEEDS OF CRIME ACT 2002 (POCA)

Money laundering has the objective of concealing the origin of money generated through criminal activity. Legislation has given a higher profile to the need to report suspicions of money laundering. The Proceeds of Crime Act (POCA) 2002 established the main offences relating to money laundering. In summary, these are:

- concealing, disguising, converting, transferring or removing criminal property from England and Wales, from Scotland or from Northern Ireland
- being concerned in an arrangement which a person knows or suspects facilitates the acquisition, retention, use or control of criminal property
- acquiring, using or possessing criminal property.

These apply to all persons in the UK in a personal and professional capacity. Any person involved in any known or suspected money-laundering activity in the UK risks a criminal conviction. Other offences under the POCA include:

- failure to disclose money-laundering offences
- tipping off a suspect, either directly or indirectly
- doing something that might prejudice an investigation – for example, falsifying a document.

9.2 The Terrorism Act 2000

This act made it an offence of money laundering to become concerned in an arrangement relating to the retention or control of property likely to be used for the purposes of terrorism, or resulting from acts of terrorism. All individuals and businesses in the UK have an obligation to report knowledge, reasonable grounds for belief or suspicion about the proceeds from, or finance likely to be used for, terrorism or its laundering, where it relates to information that comes to them in the course of their business or employment.

9.3 The Money Laundering Regulations 2007

Organisations pursuing relevant business (especially those in the financial services industry regulated by the FSA) are required to appoint a nominated officer and implement internal reporting procedures; train relevant staff in the subject; establish internal procedures with respect to money laundering; obtain, verify and maintain evidence and records of the identity of new clients and transactions undertaken and report their suspicions. In December 2007 the UK Government published the Money Laundering Regulations 2007, which replaced the Money Laundering Regulations 2003.

9.4 Local authorities

Public service organisations and their staff are subject to the full provisions of the Terrorism Act 2000 and may commit most of the principal offences under the POCA, but are not legally obliged to apply the provisions of the Money Laundering Regulations 2007. However, as responsible public bodies, they should employ policies and procedures which reflect the essence of the UK's anti-terrorist financing, and anti-money laundering, regimes. Accordingly this Council will do the following: -

a) evaluate the prospect of laundered monies being handled by them
b) determine the appropriate safeguards to be put in place
c) require every person engaged in treasury management to make themselves aware of their personal and legal responsibilities for money laundering awareness
d) make all its staff aware of their responsibilities under POCA
e) appoint a member of staff to whom they can report any suspicions. This person is the Monitoring Officer.

f) in order to ensure compliance is appropriately managed, this Council will require senior management to give appropriate oversight, analysis and assessment of the risks of clients and work/product types, systems for monitoring compliance with procedures and methods of communicating procedures and other information to personnel.
g) The officer responsible for the creation and monitoring the implementation of a corporate anti money laundering policy and procedures is the Monitoring Officer and it shall be a requirement that all services and departments implement this corporate policy and procedures.

9.5 Procedures for Establishing Identity / Authenticity Of Lenders

It is not a requirement under POCA for local authorities to require identification from every person or organisation it deals with. However, in respect of treasury management transactions, there is a need for due diligence and this will be effected by following the procedures below.

Before accepting loans from individuals, the Council will confirm the identity of the lender.

9.6 Methodologies for Identifying Deposit Takers

In the course of its Treasury activities, the Council will only lend money to or invest with those counterparties that are on its approved lending list. These will be local authorities, the PWLB, Bank of England and authorised deposit takers under the Financial Services and Markets Act 2000. The FSA register can be accessed through their website on www.fsa.gov.uk).

All transactions will be carried out by BACS or CHAPS for making deposits or repaying loans.

10 TMP 10 TRAINING AND QUALIFICATIONS

The Council recognises that relevant individuals will need appropriate levels of training in treasury management due to its increasing complexity. There are two categories of relevant individuals: -

a) Treasury management staff employed by the Council
b) Members charged with governance of the treasury management function

All treasury management staff should receive appropriate training relevant to the requirements of their duties at the appropriate time. The Council operates a Professional Development Review system which identifies the training requirements of individual members of staff engaged on treasury related activities.

Additionally, training may also be provided on the job and it will be the responsibility of the Finance Support Manager to ensure that all staff under his / her authority receive the level of training appropriate to their duties. This will also apply to those staff who from time to time cover for absences from the treasury management team.

10.1 DETAILS OF APPROVED TRAINING COURSES

Treasury management staff and members will go on courses provided by our treasury management consultants, CIPFA, money brokers etc.

10.2 RECORDS OF TRAINING RECEIVED BY TREASURY STAFF

The Finance Support Manager will maintain records on all staff and the training they receive.

10.3 APPROVED QUALIFICATIONS FOR TREASURY STAFF

Preferably CIPFA or alternatively CCAB
AAT
NVQ in Accounting
Relevant Degree
AMCT Diploma in Treasury (Joint ACT/CIPFA)

10.4 QUALIFICATIONS OF TREASURY STAFF

Finance Support Manager – CIPFA
Principal Accountant – CIPFA
Treasury Management Officer – NVQ3 in Accounting

10.5 RECORD OF SECONDMENT OF SENIOR MANAGEMENT

Records will be kept of senior management who are seconded into the treasury management section in order to gain first hand experience of treasury management operations.

10.6 STATEMENT OF PROFESSIONAL PRACTICE (SOPP)

1. The Chief Financial Officer is a member of a CCAB body and there is a professional need for the CFO to be seen to be committed to professional responsibilities through both personal compliance and by ensuring that relevant staff are appropriately trained.

2. Other staff involved in treasury management activities who are members of CIPFA must also comply with the SOPP.

10.7 Member training records

Records will be kept of all training in treasury management provided to members.

10.8 Members charged with governance

Members charged with diligence also have a personal responsibility to ensure that they have the appropriate skills and training for their role.

11 TMP 11 USE OF EXTERNAL SERVICE PROVIDERS

11.1 DETAILS OF CONTRACTS WITH SERVICE PROVIDERS, INCLUDING BANKERS, BROKERS, CONSULTANTS, ADVISERS

This Council will employ the services of other organisations to assist it in the field of treasury management. In particular, it will use external consultants to provide specialist advice in this ever more complex area. However, it will ensure that it fully understands what services are being provided and that they meet the needs of this organisation, especially in terms of being objective and free from conflicts of interest.

It will also ensure that the skills of the in house treasury management team are maintained to a high enough level whereby they can provide appropriate challenge to external advice and can avoid undue reliance on such advice.

Treasury management staff and their senior management will therefore be required to allocate appropriate levels of time to using the following sources of information so that they are able to develop suitable levels of understanding to carry out their duties, especially in challenge and avoiding undue reliance.

- The quality financial press
- Market data
- Information on government support for banks an
- The credit ratings of that government support

11.1.1 Banking services

a) Name of supplier of service is the Natwest Bank.
b) The branch address is:
Chatham Branch
148 High Street
Chatham
Kent ME4 4DJ
c) Contract commenced 01/10/05
d) Cost of service is variable depending on schedule of tariffs and volumes
e) Payments due monthly and quarterly

11.1.2 Money-broking services

The Council will use money brokers for temporary borrowing and investment and long-term borrowing. It will seek to give an even spread of business amongst the approved brokers. The performance of brokers is reviewed by the Finance Support Manager and principal account every year to see if any should be taken off the approved list and replaced by another choice and will make appropriate recommendations to change the approved brokers list to the Chief Finance Officer.

Name of broker

Tradition UK Ltd
Sterling International Brokers Ltd
Tullett Prebon (UK) Ltd
Martin Brokers (UK) Ltd
ICAP plc

11.1.3 Consultants'/advisers' services

Treasury Consultancy Services

The Council will seek to take expert advice on interest rate forecasts, annual treasury management strategy, timing for borrowing and lending, debt rescheduling, use of various borrowing and investment instruments, how to select credit worthy counterparties to\ put on its approved lending list etc.

The Finance Support Manager will review the performance of consultants every year to check whether performance has met expectations.

a) Name of supplier of service is Sector Treasury Services Limited. Their address is 17 Rochester Row, London SW1P 1QT Tel: 0871 6646800
b) Regulatory status: investment adviser authorised by the FSA
c) Contract commenced 01/06/2009 and runs for 1 year.
d) Cost of service is £19,000 per year.
e) Payments due in May and November.

External Fund Managers

a) Name of supplier of service is Investec Asset Management Limited.
b) Regulatory status: external fund manager authorised by the FSA
c) Their address is:
   2 Gresham Street
   London EC2V 7QP
b) Contract commenced 01/4/01 and is reviewed on a regular basis.
d) Fee scale is 0.15% on the first £15m and 0.125% for fund balances exceeding £15m. Fees are deducted quarterly from the income received.
e) The fund guidelines, limits, benchmarks and targets agreed with the manager are contained in the investment management agreement.
f) Valuations and performance data versus the benchmark are provided by the manager monthly. Fund performance review meetings are held semi-annually.

Other Consultancy services may be employed on short-term contracts as and when required.

11.1.4 Credit rating agency

The Council receives a credit rating service through its treasury management consultants, the costs of which are included in the consultant's annual fee.

11.2 PROCEDURES AND FREQUENCY FOR TENDERING SERVICES

See TMP2

12 TMP 12 CORPORATE GOVERNANCE

12.1 LIST OF DOCUMENTS TO BE MADE AVAILABLE FOR PUBLIC INSPECTION

a. The Council is committed to the principle of openness and transparency in its treasury management function and in all of its functions.

b. It has adopted the CIPFA Code of Practice on Treasury management and implemented key recommendations on developing Treasury Management Practices, formulating a Treasury Management Policy Statement and implementing the other principles of the Code.

c. The following documents are available for public inspection: -

Treasury Management Policy Statement
Treasury Management Strategy Statement includes Prudential Indicators and Annual Investment Strategy
Minimum Revenue provision policy statement
Annual Treasury Review Report
Treasury Management monitoring reports (e.g. half yearly)
Annual accounts and financial instruments disclosure notes
Annual budget
3-Year Capital Plan

Minutes of Council / Cabinet / committee meetings

Schedule of all external funds managed by the Council on behalf of others and the basis of attributing interest earned and costs of these investments.