ITEM 9

EXMOOR NATIONAL PARK AUTHORITY

15 February 2011

TREASURY MANAGEMENT STRATEGY STATEMENT 2011-12

Report of Chief Finance Officer

Purpose of Report: To remind Members of the requirements of the CIPFA Prudential and Treasury Management Codes, and the Local Government Act 2003 Guidance on Investments, and to adopt the proposed Treasury Management and Investment strategies for 2011-12.

Business Plan Reference: 5b5 Financial Management Service Plan

Legal and Equality Implications: Section 65(4) Environment Act 1995 – provides powers to the National park Authority to "do anything which in the opinion of the Authority is calculated to facilitate, or is conducive or incidental to:

a) the accomplishment of the purposes mentioned in s.65(1) [National Park purposes]

b) the carrying out of any functions conferred on it by virtue of any other enactment".

Further legislation includes: The Local Government Act 2003 (LGA 2003).

The CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes: Fully Revised Second Edition 2009 (CIPFA TM Code).

The CIPFA Prudential Code for Capital Finance in Local Authorities: Fully Revised Second Edition 2009 (CIPFA Prudential Code).

Financial and Risk Implications: Interest from investments forms part of the revenue income of the Authority. This income is affected by the market fluctuations in interest rates. The Authority's revenue cash is aggregated with that of Somerset County Council (SCC). SCC invests sizeable sums into the London Money Market in its name only. SCC assumes the risk of counterparty default and pays the Authority Base Rate minus 0.375%. Comfund cash is also aggregated with that of other Comfund investors and lent into the market in the name of SCC. For this, SCC assumes the risk to capital of counterparty default, but any loss of interest would reduce the overall return of the Comfund.

RECOMMENDATIONS: The Authority is RECOMMENDED to:

(1) NOTE the report of the Chief Finance Officer.

(2) APPROVE the proposed Treasury Management Strategy for 2011-12 as set out in section 4, and the Annual Investment Strategy for 2011-12 as set out in section 5 of this report.

(3) NOTE the Prudential Indicators for 2011-12 to 2013-14 as set out in paragraph 6.6 of this report (although some are currently set at zero, all Treasury Management indicators are included for completeness of information and others may well be used in the future).

1. INTRODUCTION

1.1 The CIPFA TM Code requires that each Local Authority (which includes National Park Authorities) prepare a report outlining the proposed Treasury Management policies, strategy, and activities for the coming financial year.

1.2 Section 15(1) of the LGA 2003 requires that an Annual Investment Strategy (AIS) be submitted, outlining the proposed investment strategy. This can be combined with the Treasury Management Statement, but must state explicitly where it is dealing with the guidance by the Secretary of State.

1.3 Under Section 3(1) and (2) of the LGA 2003 (duty to determine affordable borrowing limit), a Local Authority must have regard to the CIPFA Prudential Code. This code requires the setting of a number of Prudential Indicators, benchmarks within which Treasury and Investment Management, and Capital Financing are managed.

1.4 The setting of Prudential Indicators for Treasury Management requires Authorities to recognise key implications of their borrowing and investment strategies. These relate to the affordability of overall borrowing limits and the risk of exposure to interest rate changes; the maturity structure of borrowing; and longer-term investments.

1.5 This report brings together the requirements of the LGA 2003, and the revised CIPFA TM, and Prudential Codes. In presenting the Treasury Management and Investment Strategies, and the Prudential Indicators, account is taken of the current treasury position and the outlook for interest rates. They provide a transparent framework, and benchmarks within which Treasury and Investment Management, and Capital Financing are managed.

1.6. In receiving funding for its functions, the National Park Authority will turn over around £4.4 million in 2011/12. This represents significant cash movements, and it is important that the Authority has strategies and policies in place to manage such turnover effectively.

1.7 The Authority currently manages its investments and cash flow via service arrangements with the Financial Services and Treasury Management Sections of Somerset County Council. In so doing it needs to adopt policies consistent with the Council's. The Authority is, however, formally separated with its own bank accounts, and it is therefore important that it adopts Strategy Statements of its own, albeit following very closely that of the County Council.

2. TREASURY MANAGEMENT FRAMEWORK

2.1 The foundation for successful treasury management is to be found in the four key clauses in the revised CIPFA Treasury Management Code. The four clauses as recommended by CIPFA and to be adopted by the Authority into its Financial Regulations, are: -

(1) This organisation will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.

- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities. The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

(2) This organisation will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

(3) This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to its Resources and Performance Committee, and for the execution and administration of treasury management decisions to its Chief Finance Officer, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

(4) This organisation nominates its Resources and Performance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

3. TREASURY MANAGEMENT POLICY

3.1 The Authority defines its treasury management activities as: -

"The management of the organisation'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."

3.2 The Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Authority.

3.3 The Authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

4. TREASURY MANAGEMENT STRATEGY (TMS)

4.1 Introduction

4.1.1 An Authority may at times need to borrow for capital purposes as determined by the agreement of a Capital Programme. It may also need to borrow to cover short-term fluctuations in cash flow.

4.1.2 Where borrowing is required, Prudential Indicators are set as part of the framework for Treasury Management in relation to the overall borrowing limit, the level of exposure to changes in interest rates, and the maturity structure of borrowing.

4.2 Long-Term Borrowing

4.2.1 The Authority is currently debt free. Any potential borrowing would be driven by the Medium Term Financial Plan. There are no plans that would necessitate borrowing during 2011-12.

4.2.2 As stated in previous strategy statements, when future borrowing is agreed, and Prudential Indicators set, the Chief Finance Officer will make specific decisions with regard to the timing of any borrowing and the length of maturities. Borrowing would be undertaken to minimise borrowing costs, and would be consistent with the Authority's Prudential Indicators.

4.2.3 The Chief Finance Officer has the delegated power to raise capital finance from such sources as is deemed appropriate within the statutory limitations that apply to the Authority. These are termed 'borrowing instruments' and include: -

- PWLB loans – Fixed or Variable
- Transferable loan instruments
    - LOBOs (Lender Option Borrower Option Market Loans)
- Non-transferable loan instruments
    - Local bonds
    - Other (e.g. commercial loan)
- Bank overdraft

4.2.4 For such long term funding as may be required, the most likely source would be the Public Works Loan Board (PWLB). Short-term borrowing will be sought via Somerset County Council from the London money market direct from lenders or from the Authority's bankers in the form of overdraft or otherwise. Internal resources may be used in lieu of external borrowing, and leasing or soft loans will form an alternative to borrowing where appropriate.

4.3 Debt Rescheduling

4.3.1 The Authority is currently debt free.

4.4 Short-Term Borrowing

4.4.1 The daily cash flow of the Authority will be managed with that of SCC, in order to maximise the benefits for both bodies. Authority short-term cash balances are kept to a minimum in order to maximise monthly investment in the SCC Comfund. (Somerset's Comfund is the name given to a pooling of cash to allow a range of lenders who use the Somerset Treasury Management facilities to share the benefits of lending sizable sums into the London money market).

4.4.2 Whilst the pursuance of this policy is intended to maintain a positive short-term cash balance, the timing of sizable grant receipt and investment decisions for the Comfund, may mean being occasionally overdrawn for a day or so within short-term cash balances. There are accounting arrangements in place to identify daily ENPA balances held with SCC, with interest currently charged at base rate plus 1% for overdrawn balances.

4.4.3 This does not constitute an overall overdrawn balance with SCC, as the enhanced investment with SCC Comfund is offset against this. By monitoring cash flow during the month, and with the option to withdraw funds from the Comfund on a monthly basis, the Authority mitigates any risk to liquidity.

5 ANNUAL INVESTMENT STRATEGY (AIS)

5.1 Introduction

5.1.1 The Office of the Deputy Prime Minister (now Communities and Local Government) issued guidance on Local Government Investments under section 15(1) of the LGA 2003. Revised guidance became effective from 1 April 2010.

5.1.2 The overriding aim of the guidance is to encourage Authorities to invest prudently, without burdening them with detailed prescriptive regulation. The priority given to security and liquidity, rather than yield is re-emphasised. The Guidance states "Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest yield consistent with those priorities".

5.1.3 Under the guidance there are two types of investment, 'Specified' and 'Non-Specified'. Specified investments are those that offer high security and high liquidity, are made in Sterling, and with a maturity of no more than one year. Non-Specified investments are all other investments that fall outside of this description, and must be dealt with in more detail than those classified as Specified.

5.1.4 Proposals state that the AIS can be replaced by a revised strategy, if circumstances change during the year, subject to full Authority approval. There are also proposals to adopt broader use of credit ratings, more rigorous methods for assessing counterparty creditworthiness, and to report on procedures for ensuring that the Authority's staff responsible for treasury management has the right kind of training in investment management.

5.1.5 Somerset County Council is currently reviewing the arrangements under which it offers treasury management services to the Authority. Dependent on the outcome of this review, it may be necessary to bring a revised strategy to Members during 2011/12.

5.2 Investment Strategy

5.2.1 The Authority's current arrangement with SCC for the provision of treasury management services includes investment management and these arrangements will continue until such time that the Authority is informed otherwise. Under this agreement all surplus funds are lent to the County Council, as general cash balances, or in the SCC Comfund. General cash balances held with SCC currently attract a rate of base rate minus 0.375%. The return generated by the Comfund, although not fixed, has historically been above this rate. For 2010-11 the benefit of investing in the Comfund stood at £29,275 for the first nine months of the year, and is predicted to be approximately £39,000 for the year.

5.2.2 It is intended to continue to maximise returns by investing in the Comfund when possible. Cash flow balances will continue to be closely monitored to identify any funds not needed in the immediate future. Investments or disinvestments from the Comfund will be made on a monthly basis, making this an extremely liquid investment.

5.2.3 As stated in point 4.4.1, it is intended that the Authority's short-term cash balances be kept to a minimum in order to maximise monthly investment in the SCC Comfund. The timing of sizable grant receipts and the making of the investment decisions for the Comfund, may mean being occasionally overdrawn for a day or so with SCC short-term balances. The risk of non-payment of grant and debit interest of base rate plus 1% for a day or two, are more than offset by the excess returns of Comfund that would not otherwise be available for approximately 30 days (the next monthly investment/disinvestment day).

5.2.4 As SCC is the only counterparty, and no investments are for periods of over 364 days, all investments are categorised as Specified.

5.2.5 The revised Section 15(1)(a) guidance states that Authorities should review and address the needs of staff involved in treasury management for training in investment management. In addressing this, the current job specification and qualification requirement for posts involved with treasury management is deemed more than adequate for the current level of decision-making.

5.3 Counterparties for Lending

5.3.1 Somerset County Council maintains a counterparty list in compliance with guidance issued by the Secretary of State under section 15(1)(a) of the LGA 2003. This forms the basis of delegation to its Section 151 Officer who then operates his own system of 'vetting' of counterparties.

5.3.2 The Authority has given similar delegation in respect of its funds available for lending to its Chief Finance Officer, although in practice the current system is expected to continue, whereby SCC makes the transactions and carries the capital risk of counterparty default. This currently gives security of investment bettered only by the UK Government.

5.3.3 As had previously been the case with SCC, and is now a requirement of the revised CLG guidance, SCC will use a range of indicators to assess counterparties, not just credit ratings. Among other indicators to be taken into account will be: -

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Government Guarantees and Support, including ability to support.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.

5.3.4 As SCC is the only counterparty to the Authority there is no need for specific policies or procedures to be set out in this strategy to address the points above. Full details of SCC counterparty policy and procedures will be available on their website when approved by Full Council. For information the current 2010-11 SCC counterparty criteria is included for information, at Appendix A.

6 PRUDENTIAL INDICATORS

6.1 The first Prudential Indicator in respect of treasury management is that the Authority has adopted the CIPFA TM Code. The Authority adopts the content and the spirit of the code.

6.2 The Authority is required to set an ***authorised limit*** for total external debt, gross of investments, separately identifying borrowing from other long-term liabilities. The Authority is also required to set an operational limit separately identifying borrowing from other long-term liabilities. This prudential indicator is referred to as the ***operational boundary.*** They are both set for the forthcoming, and the following two years. The authorised limit will, in addition, need to provide headroom over and above the operational boundary sufficient for example to accommodate unusual cash movements. A contingency limit of £100,000 has been set for each.

6.3 The interest exposure indicators relate to either the Authority's net interest on, or to its' net principal sum outstanding on borrowing/investments. The percentage of variable rate exposure is deliberately set high because the return on the investment on the Comfund is not counted as fixed. The risk posed by this is totally mitigated because the Comfund return is reported monthly, and investment decisions are made against a known return of base rate minus 0.375%. Funds could be disinvested if the Comfund were to under-perform. With this contingency in mind, the fixed interest indicator has also been set to 100% to afford maximum flexibility.

6.4 The Authority has set for the forthcoming year, both the upper and lower limits with respect to the maturity structure of its borrowing. These indicators are referred to as the ***upper*** and ***lower limits*** respectively ***for the maturity structure of its borrowing***. The calculation is the amount of projected borrowing that is fixed rate maturing in each period, expressed as a percentage of the total projected borrowing that is fixed rate. The periods in question are: -

Under 12 months

12 months and within 24 months

24 months and within 5 years

5 years and within 10 years

10 years and above

The 'maturity structure of borrowing' indicators have been set taking into account the contingent possibility of an overdraft facility being necessary.

6.5 The final treasury management prudential indicator is referred to as the ***total principal sum invested for a period longer than 364 days***. The purpose of this indicator is to help the Authority to contain its exposure to the possibility of loss that might arise as a result of having to seek early repayment or redemption of principal sums invested. Whilst SCC makes investments of up to two years via Comfund, it does not require ENPA to separately identify and commit investment for at least one year. This indicator has therefore been set at zero for the foreseeable future.

6.6 In order that preceding Treasury and Investment Management Strategies are carried out, the following Prudential Indicators are recommended to the Authority:

	2011/12 £s	2012/13 £s	2013/14 £s
Authorised limit (borrowing only)	100,000	100,000	100,000
Operational boundary	100,000	100,000	100,000
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	100%	100%	100%

Maturity structure of borrowing

	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and < 24 months	0%	0%
24 months and < 5 years	0%	0%
5 years and < 10 years	0%	0%
10 years and above	0%	0%

	2011/12 £s	2012/13 £s	2013/14 £s
Prudential Limit for principal sums invested for periods longer than 364 days	0	0	0

7 REPORTING ARRANGEMENTS

7.1 The Chief Finance Officer will report to the Resources and Performance Committee on treasury activities in the form of an Annual Treasury Management Report after the close of the financial year.

7.2 Furthermore, in compliance with clause two of the four revised CIPFA Treasury Management clauses formally adopted, a mid-year review will be reported to the Resources and Performance Committee. Further information or updates will be produced on request.

7.2 Somerset County Council produces a monthly statement on the performance of the Comfund and this is sent to the Finance and Facilities Manager. The statement details interest earned, received, and accrued for the period, as well as capital invested, and performance statistics. Periodic reviews are also held with the Treasury Management section of Somerset County Council.

Charles Burrows
Chief Finance Officer
February 2011

SCC Lending Counterparty Criteria 2010-11 Appendix A

The following criteria will be used to manage counterparty risks to Somerset County Council Investments for new deposits from 1st April 2010: -

Financial Institutions

Any Financial Institution that is authorised by the FSA to accept deposits, or is a passported EEA institution, which is entitled to accept deposits in the UK, or is a UK Building Society can be lent to, subject to the following rating criteria at the time of the deposit: -

Rating of Counterparty	**Allowed Deposit**
<u>Deposits of less than 13 months (Refer to short and long-term ratings)</u>	
Fitch F1+ short-term and A+ long-term	£10m
Fitch F1 short-term and A+ long-term	£5m
S&P A-1+ short-term and A+ long-term	£10m
S&P A-1 short-term and A+ long-term	£5m
Moody's P-1 short-term and A1 long-term	£5m

The allowed deposit amounts above are cumulative such that the overall maximum will be £25m for a counterparty that is rated F1+, A-1+ and P-1.

A Counterparty is not to be used if it has a short-term rating equal to or lower than F2 (Fitch), A-2 (S&P) or P-2 (Moody's). A Counterparty is not to be used if it has a long-term rating equal to or lower than A (Fitch), A (S&P) or A2 (Moody's).

<u>Deposits of more than 13 months (Refer to long-term ratings)</u>	
Fitch AA-	£10m
S&P AA-	£10m
Moody's Aa3	£10m

The allowed deposit amounts above are the single maximum per counterparty at any one time, and that counterparty must be rated as above or better by all three ratings agencies.

Operational Bank Accounts

Amounts contained in operational bank accounts with the Authority's main

Bank (currently Nat West) will not count in the calculation of Nat West's limit as defined above. In the event of unexpected receipts after 2pm on any given working day, money may be placed in an instant access Nat West call account overnight, in breach of the above limits. Whenever this occurs the total lending to Nat West must be reduced to back within their limit on the following working day.

Public Sector Bodies

Any UK Local Authority or Public Body will have a limit of £15m.

The UK Government Debt Management Office (DMADF) will be unlimited.

The table below gives a definition and rough comparison of various ratings by the three main agencies: -

Definitions of Rating Agency Ratings

	Fitch		Moody's		S&P	
Short-Term	F1+	Exceptionally strong	P-1	Superior	A-1+	Extremely strong
	F1	Highest quality			A-1	Strong
	F2	Good quality	P-2	Strong	A-2	Satisfactory
	F3	Fair quality	P-3	Acceptable	A-3	Adequate
	B	Speculative	NP	Questionable	B and below	Significant speculative characteristics
	C	High default risk				
	(+) or (-)		(1,2, or 3)		(+) or (-)	
Long-Term	AAA	Highest quality	Aaa	Exceptional	AAA	Extremely strong
	AA	V High quality	Aa	Excellent	AA	Very strong
	A	High quality	A	Good	A	Strong
	BBB	Good quality	Baa	Adequate	BBB	Adequate capacity
	BB	Speculative	Ba	Questionable	BB and below	Significant speculative characteristics
	B	Highly Speculative	B	Poor		
	CCC	High default risk	Caa	Extremely poor		

Financial Groups

For Financial Groups (where two or more separate counterparties are owned by the same eventual parent company) a consolidated limit of 1.5 times the limit of the constituent counterparty within the group that has the smallest limit of the counterparties being used at the time of deposit, as calculated using the above criteria will apply. As a result the overall maximum group limit would be £37.5m.

Money Market Funds

Constant Net Asset Value (CNAV) Money Market Funds must be rated by at least two of the main three ratings agency, and must have the following ratings.

Fitch AAAmmf Moody's Aaa MR1+ Standard & Poor's AAAm

Subject to the above, deposits can be made with the following limits: -

The lower of £10m or 0.5% of the total value for individual Funds.

No more than 30% of total deposits outstanding to be held in MMFs.

Other Indicators

As had previously been the case with SCC, and is now a requirement of the revised CLG guidance, the Authority will use a range of indicators, not just credit ratings. Among other indicators to be taken into account will be: -

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Government Guarantees and Support, including ability to support.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.