REPORT TO	DATE OF MEETING
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SOUTH RIBBLE BOROUGH COUNCIL
forward with South Ribble

SUBJECT	PORTFOLIO	AUTHOR	ITEM
Treasury Strategies and Prudential Indicators 2011/12 to 2013/14	Finance & Resources	G Whitehead	7

SUMMARY AND LINK TO CORPORATE PRIORITIES

This report outlines the Council's prudential Indicators for 2011/12 to 2013/14, and sets out the expected treasury operations for this period. It also states the policy for making the minimum provision for repayment of debt.

It links to the Council's corporate priorities in the delivery of excellent services

RECOMMENDATIONS

1 That the Council approve the following

- The Prudential Indicators for 2011/12 to 2013/14
- The Treasury Management Strategy for 2011/12, incorporating the Treasury Prudential Indicators
- The Annual Investment Strategy 2011/12
- The Annual MRP Policy Statement 2011/12

DETAILS AND REASONING

The Local Government Act 2003, in giving authorities greater discretion over capital expenditure through prudential borrowing, made compliance with CIPFA's Prudential Code, and CIPFA's Treasury Management Guidance, statutory requirements. The former requires the production of Indicators showing that expenditure is affordable, the latter requires the approval of an annual Treasury Management Strategy incorporating Treasury Indicators and limits.

Consequential to the Prudential Borrowing powers is a requirement that authorities should make prudential provision for the repayment of borrowing (MRP). This is to be the subject of an annual policy statement to be made to the full Council prior to the start of each year.

Finally Authorities have, through the Local Government Act 2003, also been given greater discretion in investing surplus cash. They are required however, by guidance issued by the DCLG, to prepare an annual Investment Strategy to identify how that discretion should be applied.

This report therefore brings together these related requirements by submitting, for the approval of Council, the four statements.

No changes are proposed in any of the strategies. The Investment Strategy does however give detailed comment on Money Market Funds. These have been available for many years but the Council has not previously needed to use them. Appendix B give background information and paragraph 2.7 summarises the reasons for proposing the use of two funds.

PRUDENTIAL INDICATORS 2011/12 to 2013/14

Local Authorities have discretion to incur capital expenditure in excess of the capital resources provided by government, or those resources resulting from the sale of assets or the receipt of contributions from other parties.

To manage that process the Council must consider the following Indicators. These are designed to indicate that the expenditure is prudent and affordable.

Prudential Indicator 1 - Capital Expenditure

The following statement summarises the capital programme. It shows that prudential borrowing is planned for 2010/11 (note this does not mean that external borrowing is planned, since temporarily the Council's cash balances mean that this is not necessary). The programme is also reliant on leasing which will result in a charge to the revenue account. Provision for these costs has been built into the revenue budget.

Capital Expenditure	2010/11 Revised £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
Capital expenditure through Leisure Partnership	841	33	831	0
Financed by an increase in the long term liabilities (effectively a lease)				
The Council's capital expenditure.	5,084	2,029	3,138	2,031
Financed from the following capital resources				
Capital receipts	(46)	(38)	(20)	(20)
Grants & contributions	(2,088)	(923)	(293)	(216)
Revenue and reserves	(1,316)	(621)	(1,926)	(1,152)
Operating lease	(843)	(447)	(899)	(643)
Balance to be met from prudential borrowing	791	0	0	0

Prudential Indicator 2 - Capital Financing Requirement (CFR)

The CFR is a measure of the Council's indebtedness resulting from its capital programme. Such indebtedness is funded from leasing, borrowing, or, temporarily, by the use of the Council's internal cash balances. Ultimately it will be discharged by charges to the revenue account or by the use of available capital resources (such as grants, contributions or capital receipts).

	2010/11 Revised £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
Estimated CFR at period end	6,154	5,543	5,744	5,126
Annual change in CFR		(611)	201	(618)

It will be seen that the CFR is shown to be reducing over the four year period. This is because the repayments (of borrowing and leasing) are exceeding new liabilities.

Prudential Indicator 3 – Ratio of financing costs to the net revenue stream

This indicator shows the proportion of the Council's budget (i.e. the costs it has to meet from government grants and local taxpayers), that is required to meet the costs associated with borrowing (interest and principal, net of interest received).

	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %
Ratio	3.82	3.65	3.17

Prudential Indicator 4 – Incremental impact of capital investment decisions on the band D Council Tax

This shows the effect on Council tax levels of **changes** to the capital programme plans of the Council. It does not show the total cost of any years programme, only the results of changes between the current programme and that previously approved. It therefore reflects slippage as well as the impact of new and deleted schemes.

	2011/12 Revised £	2012/13 Estimate £	2013/14 Estimate £
Increase/(reduction) in Band D charge	(6.16)	(6.21)	(2.65)

This shows that reductions in the total capital programme for the years 2010/11 to 2013/14 have resulted in a lower council tax charge than would have been the case.

TREASURY MANAGEMENT STRATEGY 2010/11

The treasury management service fulfils an important role in the overall financial management of the Council's affairs. Whilst the prudential indicators shed light on the affordability and consequence of capital expenditure plans, the treasury service deals with any consequential borrowings, and the management of cash balances.

The Council has a statutory obligation to have regard to the CIPFA Code of Practice (revised in 2009), and is required to adopt both the Code and the Treasury Management Policy Statement therein. Both of these were adopted by Council on 3 March 2010 (Financial Regulation 4G refers)

1. Reporting

This strategy statement has been prepared in accordance with the revised Code. As a minimum, a further mid year review, and a final year end report on actual activity, will be submitted to the Council. It is intended also to submit additional reports to the Governance Committee.

2. Borrowing and Investment Projections

The Council's borrowings and investment are inter-related. The following table details the expected changes in borrowings, consistent with the capital and revenue budgets, and the balances available for investment at each year end.

	2010/11 Revised £'000	2011/12 Estimate £'000	2012/13 Estimate £'000	2013/14 Estimate £'000
Borrowing at period start	472	0	0	0
Debt repayment in year	(472)	0	0	0
Estimated borrowing in year	0	0	0	0
Est. borrowing at period end	0	0	0	0
Est. investments at period end (excluding Icelandic investments)	(5,500)	(5,066)	(4,083)	(3,923)
Net Borrowing	(5,500)	(5,066)	(4,083)	(3,923)

This projection shows no additional borrowing, for the reason that the Council is predicted to have adequate cash balances.

3. Icelandic investments

It will be noted that Icelandic investments have been excluded from the above table. The current situation with these is as follows:

- As at 1 April 2010 £3.3m was owed to the Council by the failed banks, Heritable and Landsbanki. Since then Heritable repayments of £0.3m have been received and further quarterly payments are assumed. In total £1.005m has been received from Heritable, approximately 50% of the amount claimed.
- In respect of Landsbanki, the priority status of Local Authority deposits has been challenged by other creditors and a test case involving 5 authorities will be heard in the Icelandic courts in February. The court's judgement is expected within a month. If the priority status is upheld it is hoped that the court will declare the test judgement to be binding on all authority deposits. Any decision could be challenged in the Icelandic Supreme Court; such an appeal would be heard in the summer. There would also remain the possibility of further appeal to the European court.

Prudential Indicator 7 - The Prudential Code requires authorities to make comparison between net borrowing and the CFR. At its greatest net borrowing should not exceed the current years CFR plus the estimated increases in CFR for the following two years.

In South Ribble net borrowing is negative and thus clearly within this limit.

Prudential Indicator 8 – Operational Boundary for External Debt

This is the probable, expected limit on external debt. "Debt" consists of both borrowings and other long term liabilities (finance leases, and deferred purchase liabilities incurred under the Leisure Partnership).

All borrowings have been repaid, but the liabilities under the leisure partnership arrangements will increase over the period covered by this strategy. This liability is not due to be extinguished until 2021

The principal area of uncertainty concerns the "classification" of additional leases. The capital programme assumes that certain expenditure will be financed by means of leasing and that these will be operational leases which, under current accounting rules, do not appear on the balance sheet. If this assumption changes, or if accounting regulations change, then the operational boundary may need to be reviewed. (See comments on Prudential Indicator 9 – Authorised Limit)

	31/3/11 Revised £'000	31/3/12 Estimate £'000	31/3/13 Estimate £'000	31/3/14 Estimate £'000
Expected borrowings	0	0	0	0
Other long term liabilities	1,800	1,400	2,000	1,700
Operational boundary	1,800	1,400	2,000	1,700

Prudential Indicator 9 - Authorised Limit for External Debt

This reflects a level of debt which the code defines as, "while not desired, could be afforded but may not be sustainable".

In determining this limit for South Ribble the judgement has been made that the maximum indebtedness of the Council should not exceed the Capital Financing Limit (PI 2) since this is a measure of the need for debt.

The limit so fixed would accommodate any increase in indebtedness resulting from the reclassification of leases.

	31/3/11 Revised £'000	31/3/12 Estimate £'000	31/3/13 Estimate £'000	31/3/14 Estimate £'000
Borrowings	0	0	0	0
Other long term liabilities	6,154	5,543	5,744	5,126
Authorised limit	6,154	5,543	5,744	5,126

4. Economic outlook and expected movement in interest rates

The advice of the Council's consultants is attached at Appendix A.

Not surprisingly they stress the huge economic uncertainties, and conclude that the overall balance of risk is still to the downside. They expect base rate to remain at 0.5% until the autumn of 2011, and warn of rising PWLB rates in reaction to the high volumes of government debt.

5. Borrowing strategy

The Council has no immediate need to borrow, and its balances are assumed to remain adequate throughout the period covered by this report. Even if it were thought timely to take borrowings the amounts would be small bearing in mind that its Capital Financing Requirement is little more than £6m.

To avoid additional borrowing is consistent with the objective in the Investment strategy, of limiting borrowings to amounts required looking 18 months forward (paragraph 2.3 of the Investment Strategy).

Treasury Management Limits on Activity

The Authority is required to set the following Treasury Indicators. The purpose of these is to minimise the risk resulting from movements in interest rates.

<u>Treasury Indicator 1 – Upper limit on Variable rate exposure</u>

The Council is exposed to interest rate movements on its invested cash. This varies significantly over the course of the year, and during each month. During the current year balances peaked at just below £20m for short periods. This amount will therefore form the limit

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
Upper limit on variable rate exposure -	£20m	£20m	£20m	£20m

<u>Treasury Indicator 2 – Upper limit on fixed rate exposure</u>

The Council is exposed to fixed rate interest on its long term liabilities (leased assets and deferred purchase) and has traditionally borrowed at fixed rates from the PWLB. The following limits accommodate the peak exposure each year based on current liabilities, plus a provision for possible additional leases.

	2009/10 Revised	2010/11 Estimate	2011/12 Estimate	2012/13 Estimate
Upper limit on fixed rate exposure	£3m	£2.25m	£3.2m	£2.6m

<u>Treasury Indicator 3 - Maturity structure of borrowing</u>

The Council is required to determine upper and lower limits for the maturity structure of its borrowings. The Council will have no borrowings at 31/3/11 and none are envisaged over the period covered by this strategy. Therefore the upper and lower limits are:

	2010/11	
	Lower Limit	Upper Limit
Under 12 months	0%	0%
12 months to 2 years	0%	0%
2 to 5 years	0%	0%
5 to 10 years	0%	0%
10 years and above	0%	0%

<u>Treasury Indicator 4 – Total principal sums invested for greater than 364 days</u>

It is not planned to make any investments for periods over 364 days.

6. Use of Treasury Advisors

The Council has contracted to use Sector Treasury Services as its treasury advisor for the period to 31 March 2013.

7. Performance Indicators

Investments – the generally accepted indicator is 7-day LIBID (The London Interbank Bid rate). This is the rate that could be obtained by the “passive” deposit of money onto the money market. Active investment, in normal times, should outperform this. It is recommended that this be set as an indicator.

INVESTMENT STRATEGY 2011/12

1. Introduction

1.1 Under the Power in Section (15) (1) of the Local Government Act 2003 the CLG has issued Guidance on Local Government Investments. This was updated with effect from 1 April 2010. Each Authority is recommended to produce an annual strategy that sets out its policies to manage investments, giving priority to security and liquidity. This strategy follows the updated guidance.

1.2 The major element in the guidance is that authorities should distinguish between lower risk (specified investments), and other investments (non-specified). These terms are explained in more detail below.

1.3 The specific issues to be addressed in the Investment Strategy are as follows.~~:~~

- How "high" credit quality is to be determined
- How credit ratings are to be monitored
- To what extent risk assessment is based upon credit ratings and what other sources of information on credit risk are used
- The procedures for determining which non specified investments might prudently be used
- Which categories of non-specified investments the Council may use
- The upper limits for the amounts which may be held in each category of non- specified investment and the overall total.
- The procedures to determine the maximum periods for which funds may be committed.
- What process is adopted for reviewing and addressing the needs of members and treasury management staff for training in investment management.
- The Authority's policies on investing money borrowed in advance of spending needs. The statement should identify measures to minimise such investments including limits on (a) amounts borrowed and (b) periods between borrowing and expenditure.

2. South Ribble Strategy 2011/12

<u>Objectives</u>

2.1The Council's investment priorities are:

- The security of capital and
- The liquidity of its investments.

2.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

2.3 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. The Council will restrict borrowing to a maximum of that envisaged to be required in the following eighteen months.

<u>Use of Specified and Non-Specified Investments</u>

2.4 Specified investments are those made

- with high "quality" institutions, the UK Government or a local authority,
- for periods of less than one year and
- denominated in sterling.

Other investments are "non-specified". These could include investments in gilts, bond issues by other sovereign bodies and those issued by multilateral development banks, commercial paper, and any deposits for a period exceeding one year.

In 2011 the Council will restrict its investments to those which are specified.

Counterparty Selection Criteria

2.5 In determining which institutions are "High Quality" the Council uses the creditworthiness service provided by Sector. This combines the credit ratings from all three rating agencies (Fitch, Moody, Standard and Poor) in a sophisticated modelling process. It does not however rely solely on these ratings, but also uses

- Credit watches and credit outlooks from the agencies
- Credit Default Spreads (CDS) to give early warning of likely changes in ratings
- Sovereign ratings to select counterparties from only the most credit worthy countries

These factors are combined in a scoring system, and results in counterparties being colour coded:

- Purple – recommended maximum duration 2 years
- Blue (used for nationalised and semi nationalised UK Banks) – 1 year
- Orange – 1 year
- Red – 6 months
- Green – 3 months
- No colour – not to be used

2.6 The Council has also chosen to restrict lending to UK financial institutions. Currently no such institutions attract a purple colour code.

2.7 The Council may use AAA rated Money Market Funds. A note is attached at Appendix B giving details of these funds.
The rates they earn do not, for the most part, exceed those earned on the Council's call accounts and term deposits. Their use will however enable better placement of funds when the Council's cash balances peak. It is therefore proposed to open accounts with two funds. Both of them (Prime Rate MMF and Insight MMF) are of medium size and number of clients. Prime Rate has consistently had the best performance with Insight in second place.

2.8 The Council may lend to the UK Government (which includes the Debt Management Office)

2.9 The Council may lend to other Local Authorities

Monitoring of Credit ratings

2.10 Sector supply ratings warnings and changes immediately following their issuance by the rating agencies. The colour coded counterparty lists are reissued weekly, updated by such changes.

Time and money Limits

2.11 The limits on investments in any institution were reconsidered by the Council on 24 November. No further changes are proposed. The limits applying to each category of institution are specified in the listing which is attached at the end of this Investment strategy.

Member Training

2.12 Member training was provided in 2010. Further training will be provided when required.

Current list of Financial Institutions and Investment Criteria

Invest-ment Group	Category	Institutions	Sector Colour Code	Sovereign rating	Max period	Limit per Institution
Tier 1	Sovereign or Sovereign "type"	DMADF Local Authority UK Govt backed Money market funds			6 months 1 year n/a instant access	No limit £3m £3m
Tier 2	UK Nationalised Institutions	None (N Rock deposits no longer guaranteed)				
Tier 3	Institutions guaranteed by other governments	None				
Tier 4A	UK Partly nationalised institutions; with access to funds under the Credit Guarantee Scheme	RBS group (inc Nat West) Lloyds Group (inc HBoS & Lloyds)	Blue Blue	AAA stable from all 3 agencies	12 months 12 months	£3m per group £3m per group
Tier 4B	Independent UK Institutions with access to the Credit Guarantee Scheme	HSBC Santander UK, Barclays, Nationwide	Orange Move between red and green	AAA stable from all 3 agencies	12 months 3-6 months	£2m £2m
Tier 5	Money Market Funds	None currently used	AAA only		instant access	£3m
Tier 6	Deposit/Call Account Call accounts	HSBC Santander group HBOS group RBS group			Instant access Call accounts with instant access	£3m £3m less value of term deposits

The Credit Guarantee Scheme gives access to eligible institutions to liquidity from HM Treasury

ANNUAL STATEMENT OF MRP POLICY 2011/12

Regulations specify the minimum provision that a Council must make for the repayment of its debt. This is referred to as the "MRP".

The Council will assess its MRP for 2011/12 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.

The major proportion of the MRP for 2011/12 relates to debt incurred prior to 2008/9. MRP will continue to be charged on this at the rate of 4%, in accordance with option 1 of the guidance. There are some capital schemes since then which generate a further MRP liability (i.e. capital expenditure which is not financed by any grant or contribution e.g. vehicles). The MRP liability on this will, under delegated powers, be calculated under option 3. This requires a charge over a period which is reasonably commensurate with the estimated useful life applicable to the nature of the expenditure, using the equal annual instalment method.

Estimated life periods will be determined under delegated powers with reference to the guidance. As some types of capital expenditure are not capable of being related to an individual asset, the MRP will be assessed on a basis which most reasonably reflects the anticipated period of benefit arising from the expenditure.

WIDER IMPLICATIONS

In the preparation of this report, consideration has been given to the impact of its proposals in all the areas listed below, and the table shows any implications in respect of each of these. The risk assessment which has been carried out forms part of the background papers to the report.

FINANCIAL	The financial implications are outlined within the appendices to this document
LEGAL	Compliance with various Regulations and statutory Codes of Practice
RISK	The Council's treasury management strategy and policies are designed to ensure the effective control and management of the risks associated with such activities. Although borrowing limits have been removed under the Prudential Code, it is important to note that the Government has retained the statutory power to impose limits on the capital expenditure plans of all or individual authorities.
OTHER (see below)	

Asset Management	*Corporate Plans and Policies*	*Crime and Disorder*	*Efficiency Savings/Value for Money*
Equality, Diversity and Community Cohesion	*Freedom of Information/ Data Protection*	*Health and Safety*	*Health Inequalities*
Human Rights Act 1998	*Implementing Electronic Government*	*Staffing, Training and Development*	*Sustainability*

BACKGROUND DOCUMENTS

Financial Strategy/Budget and Council Tax 2011/12
Treasury Management in the Public Services: Code of Practice
CIPFA Prudential Code for Capital Finance in Local Authorities

APPENDIX A

The following is the advice of the Council's consultants - Sector

"Economic outlook and expected movement in interest rates

The interest rate forecast is as follows:

	Mar-11	June-11	Sep-11	Dec-11	Mar-12	Sep-12	Mar-13	Sep-13	Mar-14
Bank rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	2.25%	3.00%	3.25%
5yr PWLB	3.30%	3.30%	3.40%	3.505	3.60%	3.90%	4.30%	4.80%	5.00%
10yr PWLB	4.40%	4.40%	4.40%	4.50%	4.70%	4.90%	5.10%	5.30%	5.40%
25yr PWLB	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.50%	5.60%	5.70%
50yr PWLB	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.50%	5.60%	5.70%

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, is currently in progress as at November 2011.

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.

U.K. 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 inevitable result of fiscal contraction will be major job losses during this period, in particular in public sector services. This will 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 negative trend during the summer and autumn of 2010. Mortgage approvals are also at very weak levels and declining, all of which indicates that the housing market is likely to be very weak next year.

Economic Growth – GDP growth is likely to have peaked in the current period of recovery at 1.2% in quarter 2 of 2010. The first estimate of +0.8% for quarter 3 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 are likely to 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 has gradually declined to 3.1% in September (RPI 4.6%). 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 after another rise back up to about 3.5% by the end of 2010.

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, have evaporated after the surprises of the Q3 GDP figure of +0.8% and the November Inflation Report revising the forecast for short term inflation sharply upwards.

Sector's 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 now view UK government gilts as being a safe haven from EU government debt. The consequent increase in demand for gilts helped to add downward pressure on gilt yields and PWLB rates.

Sector's forward view

It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be, 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 speed of economic recovery 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 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 for more quantitative easing, and the timing of this in both the UK and US, and its subsequent reversal
- 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

The overall balance of risks is weighted to the downside and there is some 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.

Appendix B

Money Market Funds

Money Market Funds have existed since the 1970's but Local Authorities have only been able to use them since 2002.

What are they?

Funds are managed from London but most are registered in and administered from either Dublin or Luxemburg. In light of the problems of the Irish economy, it is important to note that no investments will be made in Irish institutions because they do not meet the credit quality specified below. It should also be noted that the assets are held by custodians.

They are rated by the rating agencies. To achieve a AAA rating they must meet the following criteria;

- A minimum of 50% of their investments must be with institutions which have a short term rating (Standard and Poor) of A1+ with the remainder in A1. (Note SRBC's former criteria specified a minimum rating of A1+)
- The Weighted Average Maturity (WAM) of investments must not exceed 60days. The longest maturity of any assets, except Floating Rate Notes (FRNs), must not exceed 397 days. FRNs have a maximum of 2 years and must not exceed 5% of total assets.
- Investments with any one counterparty must not exceed 10%.
- Illiquid holdings must be less than 10%

They closely resemble unit trusts except that equities are replaced by short term money market instruments.

To ensure adequate liquidity a fund will typically have between 5% and 15% in overnight deposits.

What advantages do they afford to local authorities?

- Daily access without notice
- AAA rating
- The funds are actively managed giving enhanced returns
- Diversification across a wider range of counterparties
- The use of a wider range of financial instruments than an authority would employ.
- Better "placing power" than that available to a single authority because of the larger sums invested.

How do we select which fund to use?

Sector has invited all 25 money market funds to provide information to be included in its selection process. 20 have responded with information on

- The size of the fund
- The number of clients
- The return obtained
- Any restrictions (e.g. dealing deadlines or minimum transaction amounts)
- Fees taken by the fund manager.

Information on funds

The following table lists leading funds sorted on the basis of performance:

Fund	Fund size £m	Number of clients	Performance (net of fees) (compounded 30 day)	Fees
Prime Rate	2.034	373	0.82%	0.10%
Insight	9.304	651	0.69%	0.10%
Western Asset	0.296	86	0.65%	0.08%
Ignis	11.849	170	0.64%	0.10%
LGIM	5.272	170	0.63%	0.11%
Standard Life	5.611	512	0.58%	0.15%
Henderson	3.036	324	0.58%	0.15%
Blackrock	22.591	1,800	0.57%	0.20%

- The returns shown above compare to rates received by the Council on its call accounts of between 0.70% and 0.75%. Only Prime rate beats this.
- The funds have a differing mix of clients. 40% (148) of Prime Rate's clients are local authorities, whereas Insight has only 1% (6) council clients but a large number of pension fund clients. There is no reason to view this as significant.
- The longest duration of most investments is 90 days or less. Some of the funds studied have a some investments maturing in up to 180 days

Proposal

At times when cash balances have peaked during 2010 the Council has had to leave cash balances at its own bank because of the lack of available, suitable counterparties. Money Market Funds will enable better placement of funds at these peak times.

There is no known reason why the Council should look beyond the two leading performers in the above table. It is intended therefore to open accounts with Prime Rate and Insight.