

Treasury Management Strategy Report 2013/14

INTRODUCTION

Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management 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."

Reporting Requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Governance and Audit – As part of the committees terms of reference the above reports are presented to them for consideration and scrutiny during the year. The Committee also have delegated authority to approve in year amendments to the Treasury Management Strategy.

Treasury Management Strategy for 2013/14

The strategy for 2013/14 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) strategy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training has been undertaken by members of the Governance and Audit during in December 2012 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

Treasury management consultants

The Council uses Sector as its external treasury management advisors.

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.

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.

SECTION 1 - THE PRUDENTIAL INDICATORS 2013/14 to 2015/16**Introduction**

1. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

The Capital Expenditure Plans

2. This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

£m	2012/13 Revised £	2013/14 Estimated £	2014/15 Estimated £	2015/16 Estimated £
Capital Expenditure				
Non-HRA	3.936m	7.111m	2.733m	1.767m
HRA	4.404m	5.926m	6.324m	3.665m
Total	8.340m	13.037m	9.057m	5.432m

3. Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.
4. The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need

£m	2012/13 Revised £	2013/14 Estimated £	2014/15 Estimated £	2015/16 Estimated £
Capital Expenditure				
Non-HRA	3.936m	7.111m	2.733m	1.767m
HRA	4.404m	5.926m	6.324m	3.665m
Financed by:				
Capital receipts reserve	0.000m	4.822m	1.934m	0.971m
Capital grants	0.554m	0.254m	0.254m	0.254m
Capital reserves	6.950m	5.441m	4.324m	3.665m
Revenue	0.836m	2.520m	2.545m	0.542m
Net financing need for the year	0	0	0	0

The Council's Borrowing Need (the Capital Financing Requirement)

5. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR.
6. Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR
7. The Council is asked to approve the CFR projections below:

£m	2012/13 Revised £	2013/14 Estimated £	2014/15 Estimated £	2015/16 Estimated £
Capital Financing Requirement				
CFR – Non Housing	4.476m	4.297m	4.125m	3.960m
CFR - Housing	124.480m	124.480m	124.480m	124.480m
Total CFR	128.956m	128.777m	128.605m	128.440m
Movement in CFR	(0.187m)	(0.179m)	(0.172m)	(0.165m)

£m	2012/13 Revised £	2013/14 Estimated £	2014/15 Estimated £	2015/16 Estimated £
Movement in CFR represented by				
Net Financing need for the year (above)	0.000m	0.000m	0.000m	0.000m
Less MRP/VRP and other financing movements	(0.187m)	(0.179m)	(0.172m)	(0.165m)
Movement in CFR	(0.187m)	(0.179m)	(0.172m)	(0.165m)

8. The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments (VRP). The MRP is the reason for the negative year on year movements in the CFR forecasts shown above.
9. CLG Regulations have been issued which require full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils to replace the existing Regulations, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement.
10. For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:
 - **Existing practice** - MRP will follow the existing practice outline in former CLG Regulations.

11. From 1 April 2008 for all new unsupported borrowing the MRP policy will be:

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Directive).

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

12. For authorities who participate in LAMS using the cash backed option, the mortgage lenders require a five year deposit from the local authority to match the five year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application

Core Funds and Expected Investment Balances

13. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2012/13 Revised £	2013/14 Estimated £	2014/15 Estimated £	2015/16 Estimated £
Fund balances	10.221m	11.949m	15.006m	18.437m
Capital receipts	7.406m	3.896m	3.049m	2.590m
HRA reserve	9.861m	10.005m	10.503m	14.293m
Major Repairs Reserve	5.109m	5.383m	6.259m	7.794m
Total Core Funds	32.597m	31.233m	34.817m	43.114m
Working Capital*	1.571m	1.571m	1.571m	1.571m
Expected Investments	34.168m	32.804m	36.388m	44.685m

* Working capital balances shown are estimated year end; these may be higher mid year

Affordability Prudential Indicators

14. The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the overall Council's finances. The Council is asked to approve the following indicators:

15. **Actual and Estimates of the ratio of financing costs to net revenue stream –** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2012/13 Revised	2013/14 Estimated	2014/15 Estimated	2015/16 Estimated
Non-HRA	(2.47%)	(1.74%)	(2.32%)	(3.01%)
HRA	16.84%	14.95%	14.18%	12.79%

16. The estimates of financing costs include current commitments and the proposals in this budget report.

17. **Incremental impact of capital investment decisions on the Council Tax –** This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of government support, which are not published over a three year period.

18. **Incremental impact of capital investment decisions on the Band D Council Tax**

£	2012/13 Revised	2013/14 Estimated	2014/15 Estimated	2015/16 Estimated
Variance change in original to revised spending programme	(£1.72)	£2.81	£0.42	(£0.23)

19. **Estimates of the incremental impact of capital investment decisions on Housing Rent levels –** Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

20. Incremental impact of capital investment decisions Housing Rent levels

£	2012/13 Revised	2013/14 Estimated	2014/15 Estimated	2015/16 Estimated
Variance change in original to revised spending programme	(£1.12)	£340.57	£260.55	(£168.17)

21. This indicator shows the revenue impact on any newly approved schemes if there was no rent restructuring in place. However, there is no actual impact on rent levels through any decisions on capital investments due the operation of rent restructuring currently.

SECTION 2 - Borrowing**Debt and Investment Projections 2012/13 – 2014/15**

22. The capital expenditure plans set out in Section 1 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current Portfolio Position

23. The Councils revised treasury portfolio position at 31 March 2013, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (CFR), highlighting any over or under borrowing.

£m	2012/13 Revised £	2013/14 Estimated £	2014/15 Estimated £	2015/16 Estimated £
External Debt				
Existing Debt at 1 April	(124.217)m	(120.969m)	(116.721m)	(113.486m)
Expected change in debt	0.026m	1.026m	0.013m	0.500m
HRA Settlement	3.222m	3.222m	3.222m	3.222m
Debt at 31 March	(120.969m)	(116.721m)	(113.486m)	(109.764m)
CFR	128.956m	128.777m	128.605m	128.440m
Under / (over) borrowing	7.987m	12.056m	15.119m	18.676m
Total Investments at 31 March				
Investment change	32.597m	33.491m	39.129m	46.917m
Net Debt	(86.801m)	(81.659m)	(72.786m)	(61.277m)

24. Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes
25. The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report

Limits to Borrowing Activity

26. **The Operational Boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational Boundary £m	2012/13 Revised £	2013/14 Estimated £	2014/15 Estimated £	2015/16 Estimated £
Debt	2.539m	1.513m	1.500m	1.000m
+ HRA Reform	121.652m	118.430m	115.209m	111.987m
Other long term liabilities	0.000m	0.000m	0.000m	0.000m
Total	124.191m	119.943m	116.709m	112.987m

27. **The Authorised Limit for External Debt** – A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

28. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

29. The Council is asked to approve the following Authorised:

Authorised limit £m	2012/13 Revised £	2013/14 Estimated £	2014/15 Estimated £	2015/16 Estimated £
Debt	18.000m	18.000m	18.000m	18.000m
+ HRA Reform	121.652m	118.430m	115.209m	111.987m
Other long term liabilities	0.000m	0.000m	0.000m	0.000m
Total	139.652m	136.430m	133.209m	129.987m

Prospects for Interest Rates

30. The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Annex 1 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

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2012	0.50	1.50	3.70	3.90
March 2013	0.50	1.50	3.70	3.90
June 2013	0.50	1.50	3.70	3.90
Sept 2013	0.50	1.60	3.80	4.00
Dec 2013	0.50	1.70	3.80	4.00
March 2014	0.50	1.80	3.90	4.10
June 2014	0.50	1.90	4.00	4.20
Sept 2014	0.50	2.00	4.10	4.30
Dec 2014	0.50	2.10	4.20	4.40
March 2015	0.75	2.30	4.30	4.50

31. The UK continues its worst and slowest recovery from recession in recent history. Growth prospects are weak, although the economy did come out of recession in the third quarter of 2012. Consumer spending, the driving force of recovery, is likely to remain under pressure due to the repayment of personal debt, general malaise about the economy and employment fears.
32. The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Eurozone so the difficulties in this area are likely to continue to hinder UK growth. The US, the main world economy, faces similar debt problems to the UK, but is unlikely to address these before the outcome of the Presidential elections in November 2012. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth from the original expectations and is likely to see the UK deficit reduction plans slip.
33. This challenging and uncertain economic outlook has several key treasury management implications:
- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
 - Investment returns are likely to remain relatively low during 2013/14 and beyond;
 - Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully;
 - There will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

A more detailed economic outlook for both the Global and UK economy is included in Annex 2.

Borrowing Strategy 2013/14 – 2015/16

34. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council’s reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high and will be maintained for the borrowing excluding the HRA reform settlement
35. Against this background and the risks within the economic forecast, caution will be adopted with the 2012/13 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.
36. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.
37. The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

Treasury Management Limits on Activity

38. There are three debt related treasury activity limits. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:
 - Upper limits on variable interest rate exposure – This identifies a maximum limit for variable interest rates based upon the debt position net of investments
 - Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.
 - Maturity structures of borrowing – These gross limits are set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

39. The Council is asked to approve the limits:

£m	2012/13	2013/14	2014/15	2015/16
Interest rate Exposures				
	Upper	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	125.000m	125.000m	125.000m	125.000m
Limits on variable interest rates based on net debt	40.000m	40.000m	40.000m	40.000m
Maturity Structure of fixed interest rate borrowing 2013/14				
		Lower	Upper	Upper
Under 12 months		0%	40%	0%
12 months to 2 years		0%	40%	40%

2 years to 5 years	0%	100%	100%
5 years to 10 years	0%	100%	100%
10 years and above	0%	100%	100%

Policy on Borrowing in Advance of need

40. 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 within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
41. The Head of Finance may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Head of Finance will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.
42. It would not look to borrow more than 24 months in advance of need.
43. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt Rescheduling

44. As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential 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 current treasury position and the size of the cost of debt repayment (premiums incurred).
45. 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 treasury strategy;
 - enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
46. Consideration will also be given to identify if there is any residual potential 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.

SECTION 3 - ANNUAL INVESTMENT STRATEGY

Investment Policy and Counterparty Selection Criteria

47. The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second and then return.
48. In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using the Sector ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.
49. Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Sector in producing its colour codings which show the varying degrees of suggested creditworthiness.
50. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
51. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.
52. Investment instruments identified for use in the financial year are listed in annex 3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

Creditworthiness policy

This Council applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following 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.

53. 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 coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands (please amend as appropriate):

- 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

54. The Sector creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

55. Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

56. All credit ratings are monitored daily and 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 spreads 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 Council's lending list.

57. 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 supporting government.
58. The Local Authority Mortgage Scheme (LAMS) – The Council is currently participating in the cash backed mortgage scheme which requires the Council to place a matching five year deposit to the life of the indemnity. This investment is an integral part of the policy initiative and is outside the criteria above.

Investment Strategy

59. **In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).
60. **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 1 of 2015. Bank Rate forecasts for financial year ends (March) are:
- 2012/13 0.50%
 - 2013/14 0.50%
 - 2014/15 1.00%
 - 2015/16 1.50%
61. There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.
62. The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next five years are as follows:
- 2012/13 0.50%
 - 2013/14 0.50%
 - 2014/15 0.70%
 - 2015/16 1.50%
63. **Investment treasury indicator and limit** - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.
64. The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days			
£m	2013/14	2014/15	2015/16

Principal sums invested > 364 days	£9.000m	£10.000m	£12.000m
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65. **Risk Benchmarking** – A development in the revised Codes and the CLG Investment Guidance is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting, although the application of these is more subjective in nature.

66. These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

67. **Security** - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.1% historic risk of default when compared to the whole portfolio.

68. **Liquidity** – In respect of this area the Council seeks to maintain:

- Bank overdraft - £0.25m
- Liquid short term deposits of at least £5m available with a week's notice.
- Weighted Average Life benchmark is expected to not exceed a maximum of 1 year.

69. **Yield - Local measures of yield benchmarks are :**

- Investments – Internal returns above the 7 day LIBID rate
- Investments – External fund managers - returns 10% above 7 day compounded LIBID.

70. **And in addition that the security benchmark for each individual year is:**

	1 year	2 years	3 years	4 years	5 years
Maximum	0.08%	0.22%	0.37%	0.52%	0.70%

Note: This benchmark is an average risk of default measure (potential loss on investments), and would not constitute an actual expectation of loss against a particular investment.

End of year Investment Report

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

Policy on Use of External Service Providers

72. The Council uses Sector as its external treasury management advisors.

73. 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.

74. 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.

Annex 1 - Interest Rate Forecast 2013/2015

Sector's Interest Rate View														
	Now	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
3 M onth LIBID	0.39%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%	1.40%	1.70%
6 M onth LIBID	0.54%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%	1.60%	1.90%
12 M onth LIBID	0.88%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%	1.80%	2.10%
5yrPW LB Rate	1.84%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
10yrPW LB Rate	2.84%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
25yrPW LB Rate	3.98%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
50yrPW LB Rate	4.11%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
Bank Rate														
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yrPW LB Rate														
Sector's View	1.84%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
UBS	1.84%	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.84%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	-	-	-	-	-
10yrPW LB Rate														
Sector's View	2.84%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
UBS	2.84%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	-	-	-	-	-
Capital Economics	2.84%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	-	-
25yrPW LB Rate														
Sector's View	3.98%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
UBS	3.98%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	-	-	-	-	-
Capital Economics	3.98%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-	-	-	-	-
50yrPW LB Rate														
Sector's View	4.11%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
UBS	4.11%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	-	-	-	-	-
Capital Economics	4.11%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

Annex 2 – Economic Background

Global economy

The Eurozone debt crisis has continued to cast a pall over the world economy and has depressed growth in most countries. This has impacted the UK economy which is unlikely to grow significantly in 2012 and is creating a major headwind for recovery in 2013. Quarter 2 of 2012 was the third quarter of contraction in the economy; this recession is now the worst and slowest recovery of any of the five recessions since 1930. The Eurozone sovereign debt crisis has abated somewhat following the ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bailout. The immediate target for this statement is Spain which continues to prevaricate on making such a request and so surrendering its national sovereignty to IMF supervision. However, the situation in Greece is heading towards a crunch point as it fails yet again to live up to its commitments to reduce its annual government deficits in line with the agreement under the second bailout. This is jeopardising the next tranche of bailout monies, without which, Greece will run out of cash before the end of 2012. Many commentators view a Greek exit from the Euro as inevitable and question whether the current coalition government would disintegrate if even more severe austerity measures were to be attempted. The question is more in terms of how much damage would a Greek exit do and whether contagion would spread to cause Portugal and Ireland to also leave the Euro.

Sentiment in financial markets has improved considerably following this ECB action, the German courts agreeing that the bailout mechanisms are legal, and the Dutch general election voting for pro Eurozone policies. However, the foundations to this "solution" to the Eurozone debt crisis are flimsy and events could easily conspire to put this into reverse.

The US economy has only been able to manage disappointingly weak growth in 2012 despite huge efforts by the Federal Reserve to stimulate the economy by liberal amounts of quantitative easing (QE) combined with a commitment to a continuation of ultra low interest rates into 2015. Unemployment levels have been slowly reducing but against a background of a fall in the numbers of those available for work. The fiscal cliff facing the new President at the start of 2013 has been a major dampener discouraging business from spending on investment and increasing employment more significantly in case there is a sharp contraction in the economy in the pipeline. However, the housing market does look as if it has, at long last, reached the bottom and house prices are now on the up.

Hopes for a broad based recovery have, therefore, focused on the emerging markets. However, there are increasing concerns over flashing warning signs in various parts of the Chinese economy that indicate it may be heading for a hard landing rather than a gradual slow down.

UK economy

The Government's austerity measures, aimed at getting the public sector deficit into order over the next four years, now look as if they will fail to achieve their objectives in the original planned timeframe. Achieving this target is dependent on the UK economy growing at a reasonable pace but recession in the Eurozone, our biggest trading partner, has depressed growth whilst tax receipts have not kept pace with additional welfare benefit payments. It will be important for the Government to retain investor confidence in UK gilts so there is little room for it to change course other than to move back the timeframe.

Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is seen as a safe haven from Eurozone debt. There is, though, little evidence that consumer confidence levels are recovering nor that the manufacturing sector is picking up. On the positive side, growth in the services sector has rebounded in Q3 and banks have made huge progress since 2008 in shrinking their balance sheets to more manageable levels and also in reducing their dependency on wholesale funding. However, availability of credit remains tight in the economy and the Funding for Lending scheme, which started in August 2012, has not yet had the time to make a significant impact. Finally, the housing market remains tepid and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth. With the exception of recently released Q3 data, economic growth has, basically, flat lined since the election of 2010 and, worryingly, the economic forecasts for 2012 and beyond were revised substantially lower in the Bank of England Inflation quarterly report for August 2012. Quantitative Easing (QE) was increased again by £50bn in July 2012 to a total of £375bn. Many forecasters are expecting a further round of QE to stimulate economic activity regardless of any near-term optimism.

Unemployment. The Government's austerity strategy has resulted in a substantial reduction in employment in the public sector. Despite this, total employment has increased to the highest level for four years by August 2012 and the numbers of unemployment benefit claimants have also been falling slightly.

Inflation and Bank Rate. Inflation has fallen sharply during 2012 from a peak of 5.2% in September 2011 to 2.2% in September 2012. Inflation is expected to fall further to the 2% target level within the two year horizon.

AAA rating. The UK continues to enjoy an AAA sovereign rating. However, the credit rating agencies will be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years.

Sector's forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains relatively fragile and whilst there is still a broad range of views as to potential performance, expectations have all been downgraded during 2012. Key areas of uncertainty include:

- the potential for the unravelling of the second Greek bailout package causing a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
- inter government agreement on how to deal with the Eurozone debt crisis could fragment; the impact of the Eurozone crisis on financial markets and the banking sector;
- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;

- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that are unlikely to be achieved;
- the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;
- stimulus packages failing to stimulate growth;
- elections due in the US and Germany in 2012 and 2013 respectively;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.
- the potential for action to curtail the Iranian nuclear programme
- the situation in Syria deteriorating and impacting other countries in the Middle East

The overall balance of risks remains weighted to the downside. Many consumers, corporates and banks are still focused on reducing their borrowings rather than spending so this will continue to act as a major headwind to a return to robust growth.

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.

Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before the end of 2014 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

Annex 3

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 23 June 2004 and will apply its principles to all investment activity. In accordance with the Code, the Head of Finance has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

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

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

The investment policy proposed for the Council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is small. The Council's Treasury Management Officer is restricted to placing Specified Investment funds with:

Table A – Specified Investments

	Specified Investments Category	Limit
a	<p>A body of high credit quality, this category includes the following –</p> <ul style="list-style-type: none"> <input type="checkbox"/> A UK bank or building society using Sector Creditworthiness service, with a minimum colour band of GREEN <input type="checkbox"/> Nationalised and Part nationalised banks can be included within specified investments as long as they remain part-nationalised 	<p>£10m per institution or a maximum of 30% of total investment (whichever is the greatest), £10m per corporate group</p>
b	<p>The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity)</p>	no amount limit
c	<p>UK local authorities</p>	<p>£5m per LA, £10m all LAs</p>
d	<p>Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. This category covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor’s, Moody’s or Fitch rating agencies.</p> <p>CLG Investment Guidance specifies that Money Market Funds with high credit ratings are classified as Specified Investment. These funds are instant access investment. There is possibility that part of the investment may be exposed to counterparties the Council would not approve normally or invest directly. The counterparty risk is mitigated by that –</p> <ul style="list-style-type: none"> • The Fund Managers diversify investment in a range of counterparties; • The Funds are instant access; • The Council only invests in funds rated AAA; • DCLG Investment Guidance classifying such funds as Specified Investment. 	<p>£5m per fund,</p>

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

Amounts invested with any one institution shall not exceed £2m for periods of more than 2 years. Amounts invested with any one corporate group shall not exceed £5m (with the exception of Councils own bank).

Amounts invested in non specified fixed term investment would normally not exceed 25% of the total Invested. The Head of Finance has the discretion if required to exceed the limit which may occur during the course of the year should rate of return on investment be beneficial to the council. Any decision will be based on taking into account current and future market conditions as well counterparty strength and rating. If these circumstances are required this will be reported back to the appropriate committee.

Table B – Non Specified Investments

	Non Specified Investment Category	Limit
a.	Any institutions meeting the criteria set out for Specified Investments , with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£4m maximum of 2-years per institution
b.	Councils Bank – Should its ratings fall below that required for specified investment, monies will be restricted to instant access.	£7m
c.	Top 10 building societies, by asset value.	£2m maximum of 2-years per institution. £6m for all B/S sector

Local Authority Mortgage Scheme. Under this scheme the Council will place a maximum fund of £5m, with one of the approved lenders participating in the LAMS scheme for a fixed period of 5 years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the Specified / Non specified categories

Use of External Fund Managers –The Council currently uses external fund managers for part of its investment portfolio. The Council is not restricted to placing funds with cash managers, and will manage funds in house, use fund managers, or brokers if it is appropriate to do so.

The fund managers will use both specified and non-specified investment categories, and are contractually committed to keep to the Council’s investment strategy. Currently the Council has an agreement with Tradition UK and Sterling International. The fund managers are required to adhere to the following:

- All investments restricted to sterling denominated instruments;

Appendix I

- Amounts invested with any one institution or Corporate Group should not exceed the limits specified in Table A and Table B.
- Portfolio management is measured against the return provided by the 3 month sterling LIBID, or in accordance with the measures specified in the contract.

The performance of investment managed by Fund Managers is reviewed at least quarterly by the Head of Finance.

Ethical Investment Statement - The council has approved the following ethical investment statement that will apply to all cash investments made by, or on behalf of, the council

“The Council, in making investments through its treasury management function, fully supports the ethos of socially responsible investments. We will actively seek to communicate this support to those institutions we invest in as well as those we are considering investing in by:

- encouraging those institutions to adopt and publicise policies on socially responsible investments;
- requesting those institutions to apply council deposits in a socially responsible manner.”

Counterparties shall be advised of the above statement.

Annex 4

Risk Management – The Council undertakes risk assessment for all fixed term deposits or greater than one month. The risk assessment uses the following template –

Risk assessment of new investment (last updated March 2011)

Investment	Institution	Risk Assessment		
Investment Product	Institution name	<i>Risk of the counterparty defaulting on investment</i>		
			<i>Likelihood</i>	
		Counterparty on our specified list: Instant access	1.4	
		Counterparty only on non specified list: Instant access	1.7	
Principal Value	Eligibility	Counterparty on our specified list: <=364 days	2	Unlikely
		Counterparty on our specified list: <=3 months	1	Unlikely
		Counterparty only on non specified list: <=364 days	2.4	
		Counterparty only on non specified list: >364 days	3	Likely
Term	Limit with this institution			
		<i>Impact of losing the investment</i>		<i>Impact</i>
Rate	Existing investment value	Total principal less than £700,000	1	Negligible
		Total principal between £700,000 and £1.4m	2	Minor
		Total principal between 1.4m and £3.5m	3	Major
Rate %	Value inc new investment	Total principal greater than £3.5m	4	Critical
		Risk Score :		
Internal Reference	Is it within the limit?			

Risk assessed by:

Risk assessment date: