Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2012-13

1. Introduction

1.1 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 occasions 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. "

1.2 Reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by the Budget & Strategic Planning Working Group before being recommended to the Council.

Prudential and Treasury Indicators and Treasury Strategy - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision 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.

1.3 Treasury Management Strategy for 2012/13

The strategy for 2012/13 covers two main areas:

Capital Issues
- the capital plans and the prudential indicators;
- the MRP strategy.

Treasury management Issues
- the current treasury position;
- treasury indicators which will 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 CIFPA Prudential Code, the CLG MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

2. The Capital Prudential Indicators 2012/13 – 2014/15

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

A key issue facing the Council is the impact of the HRA reform. This essentially ends the impact of the housing subsidy system and sees the HRA as a stand alone business, without any impact arising from housing reform. The legislation has now been approved, but the Council will need to approve revised limits now that the reform is going ahead.

The Council currently pays into the HRA housing subsidy system, and in order to stop future payments from 1 April 2012 the Council is required to pay the CLG £27.8m. This payment is effectively HRA debt, and so the prudential indicators have been adjusted to reflect this change. The actual payment will be made on the 28 March 2012 and so the indicators will take immediate effect from the approval of these limits by Council. The change is expected to be beneficial to the Council.

Capital Expenditure. 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:

Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

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 need (borrowing).

Capital Expenditure	**2010/11 Actual £000**	**2011/12 Estimate £000**	**2012/13 Estimate £000**	**2013/14 Estimate £000**	**2014/15 Estimate £000**
Non-HRA	4,230	3,930	2,876	633	430
HRA	939	1,591	1,572	2,383	2,037
HRA settlement	0	27,811	0	0	0
Total	5,169	33,332	4,448	3,016	2,467
Financed by:					
Capital receipts	113	432	213	255	56
Capital grants	359	252	100	495	100
Capital reserves	4,109	3,979	1,068	2,099	2,146
Revenue	14	187	654	167	165
Net financing need for the year	**574**	**28,482**	**2,413**	**0**	**0**

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

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

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.

The Council is asked to approve the CFR projections below:

	2010/11 Actual £000	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Capital Financing Requirement					
CFR – non housing	5,297	5,740	7,913	7,595	7,298
CFR - housing	4,296	4,282	4,267	4,253	4,239
HRA Settlement	0	27,811	27,811	27,811	27,811
Total CFR	**9,593**	**37,833**	**39,991**	**39,659**	**39,348**
Movement in CFR	**313**	**28,240**	**2,158**	**-332**	**-311**

Movement in CFR represented by					
Net financing need for the year including HRA Settlement (above)	574	28,482	2,413	0	0
Less MRP/VRP and other financing movements	-261	-242	-255	-332	-311
Movement in CFR	**313**	**28,240**	**2,158**	**-332**	**-311**

MRP Policy Statement

The Council is required to` pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement*:*

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR** – MRP will be based on the CFR (option 2);

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) 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 Direction) (option 3);

This option provides for a reduction in the borrowing need over approximately the asset’s life.

No revenue charge is currently required for the HRA. However under HRA reform the HRA will be required to charge depreciation on its assets, which will have a revenue effect. In order to address any possible adverse impact, regulations will allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years.

Repayments included in annual PFI or finance leases are applied as MRP.

The Use of the Council's Resources and the Investment Position

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.

Affordability Prudential Indicators

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 Council's overall finances. The Council is asked to approve the following indicators:

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.

	2010/11 Actual %	2011/12 Estimate %	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %
Non-HRA	5.52	5.41	5.95	6.96	6.65
HRA (inclusive of settlement)	3.01	2.68	24.13	23.08	22.14

The significant increased percentage for the HRA in 2012/13 is due to the increased financing costs arising out of the increased debt taken on for the HRA Reform. These increased costs are mitigated within the HRA budget itself through the removal of the payment of excess subsidy to the Government.

In relation to the Non HRA increase from 2013/14 this primarily relates to MRP charges which will accrue following the completion of the redevelopment works for Waterfield Leisure Pool by the end of 2012/13.

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

Estimates of the incremental impact of capital investment decisions on 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.

Incremental impact of capital investment decisions on the band D council tax

	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Council tax - band D	-0.46	2.22	-4.27	-12.28

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.

Incremental impact of capital investment decisions on housing rent levels

	2011/12 Estimate £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Weekly housing rent levels	0.00	0.00	0.00	0.00

This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

3. Treasury Management Strategy

The capital expenditure plans set out in Section 2 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 approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2011, with forward projections are summarised below. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2010/11 Actual £000	**2011/12 Estimate £000**	**2012/13 Estimate £000**	**2013/14 Estimate £000**	**2014/15 Estimate £000**
External borrowing					
Borrowing at 1 April	8,588	6,988	6,738	8,738	8,738
Expected change in borrowing	-1,600	-250	2,000	0	0
HRA settlement	0	27,811	27,811	27,811	27,811
Other long-term liabilities (OLTL)	221	221	216	203	190
Expected change in OLTL	0	-5	-13	-13	-13
Actual borrowing at 31 March	**7,209**	**34,765**	**36,752**	**36,739**	**36,726**
CFR – the borrowing need	**9,593**	**37,833**	**39,991**	**39,659**	**39,348**
Under / (over) borrowing	**2,384**	**3,068**	**3,239**	**2,920**	**2,622**
Investments					
Total investments at 31 March					
Investment change	3,150	395	228	61	0
Net borrowing	**4,059**	**34,370**	**36,524**	**36,678**	**36,726**

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 borrowing, 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 2012/13 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.

The Head of Central Services 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.

3.2. Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the limit beyond which external borrowing 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 borrowing.

Operational boundary	2011/12 Revised Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Borrowing	8,738	10,738	10,738	10,738
Add HRA settlement	27,811	27,811	27,811	27,811
Other long term liabilities	216	203	190	177
Total	36,765	38,752	38,739	38,726

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

1. 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 this power has not yet been exercised.
2. The Council is asked to approve the following Authorised Limits:

Authorised limit	2011/12 Revised Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Borrowing	18,973	20,986	20,999	21,012
Add HRA settlement	27,811	27,811	27,811	27,811
Other long term liabilities	216	203	190	177
Total	47,000	49,000	49,000	49,000

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit	2011/12 Estimate £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Total	33,742	33,742	33,742	33,742

3.3. Prospects for Interest Rates

A more detailed interest rate view and economic commentary is at Appendices 1 and 2.

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. Appendix 1 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives their central view.

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	25 year	50 year
March 2012	0.50	0.70	1.50	2.30	4.20	4.30
June 2012	0.50	0.70	1.50	2.30	4.20	4.30
Sept 2012	0.50	0.70	1.50	2.30	4.30	4.40
Dec2012	0.50	0.70	1.60	2.40	4.30	4.40
March 2013	0.50	0.75	1.70	2.50	4.40	4.50
June 2013	0.50	0.80	1.80	2.60	4.50	4.60
Sept 2013	0.75	0.90	1.90	2.70	4.60	4.70
Dec 2013	1.00	1.20	2.20	2.80	4.70	4.80
March 2014	1.25	1.40	2.40	2.90	4.80	4.90
June 2014	1.50	1.60	2.60	3.10	4.90	5.00

Growth in the UK economy is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Monetary Policy Committee inflation target. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

Fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16; the consequent increase in gilt issuance is therefore expected to be reflected in an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved.

This challenging and uncertain economic outlook has a several key treasury mangement implications:

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher 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 2012/13;
- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

3.4 Borrowing Strategy

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.

Against this background and the risks within the economic forecast, caution will be adopted with the 2012/13 treasury operations. The Head of Central Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

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

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

The requirement for the HRA reform settlement to be made to the CLG on 28 March 2012 will require a separate consideration of a borrowing strategy. The Council will need to have the cash settlement amount of £27.8m available by the 28th March 2012, so separate borrowing solely for this purpose is anticipated. The PWLB are providing loans at interest rates 0.85% lower than the usual PWLB interest rates solely for the settlement requirements. This provides a compelling reason to utilise this borrowing availability. The exact structure of debt to be drawn is curently being considered by officers to ensure it meets the requirements of the HRA business plan and the overall requirements of the Council. Whilst the debt can be drawn earlier than needed, this may incur a revenue cost, and will be considered when a review of the structure of actual prevailing borrowing and investment interest rates is undertaken nearer to the time.

The uncertainty over future interest rate increases the risks associated with treasury activity. As a result, the Council will take a cautious approach to its treasury strategy.

Treasury Management Limits on Activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any 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. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure 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.

The Council is asked to approve the following treasury indicators and limits:

	2011/12 Revised £m	2012/13 £m	2013/14 £m	2014/15 £m
Interest rate Exposures				
	Upper	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	40	41	40	40
Limits on variable interest rates based on net debt	7	8	9	9

Maturity Structure of fixed interest rate borrowing 2012/13		
	Lower	**Upper**
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	100%
Maturity Structure of variable interest rate borrowing 2012/13		
	Lower	**Upper**
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	100%

3.5 Policy on Borrowing in Advance of Need

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.

Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 100% of the expected increase in borrowing need (CFR) over the three year planning period; and
- Would not look to borrow more than 24 months in advance of need.

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.

3.6. Debt Rescheduling

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).

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).

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.

All rescheduling will be reported to the **Council** at the earliest meeting following its action.

3.7. Annual Investment Strategy

3.7.1 Investment Policy

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, then return.

Investment instruments identified for use in the financial year are listed in appendix 3 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

3.7.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. 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.

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 duration for investments. The Council will therefore use counterparties within the following durational bands:

- 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

* This category is for AAA rated Government debt or its equivalent.

This methodology does not apply the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. 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 reliance on just one agency's ratings.

All credit ratings will be monitored on a regular basis with a revised counterparty list sent on a weekly basis. This will incorporate any rating changes that have occurred that week. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark (this is an index based on the equal weighting of the top 25 Credit Default Swap financial companies in Europe) 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.

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

3.7.3 Investment Strategy

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).

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 of 2013. Bank Rate forecasts for financial year ends (March) are:

- 2011/ 2012 0.50%
- 2012/ 2013 0.50%
- 2013/ 2014 1.25%
- 2014/ 2015 2.50%

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.

Interest rates on investments placed for periods of three months during each financial year for the next five years may be as follows:

2012/13	0.70%
2013/14	1.00%
2014/15	1.60%
2015/16	3.30%
2016/17	4.10%

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.

The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days			
	2012/13 £m	2013/14 £m	2014/15 £m
Principal sums invested > 364 days	£5m	£5m	£5m

1.The budget above for 2012/13 of 0.70% assumes that Bank Rate starts increasing from quarter 3 of 2013. There is downside risk to this forecast i.e. that the start of increases in Bank Rate is delayed even further if economic growth is weaker than expected. There is also upside risk if the Monetary Policy Committee (MPC) decides it needs to start increasing Bank Rate to defend its credibility in containing inflation and inflation expectations of the public.

For its cash flow generated balances, the Council will seek to utilise its money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

3.7.4 Investment Risk Benchmarking These benchmarks are simple guides to maximum risk, so they 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 to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

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

- **0.08% historic risk of default when compared to the whole portfolio.**

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft – up to £1.0m
- Liquid short term deposits of at least £250,000 available with a week's notice.
- Weighted Average Life benchmark is expected to be 1.5 years, with a maximum of 3 years.

Yield - local measures of yield benchmarks are:

- Investments – to achieve a return in excess of the 7 day rate

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

	1 year	2 years	3 years	4 years	5 years
Maximum	**0.06%**	**0.06%**	**0.08%**	**N/A**	**N/A**

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

3.8 End of year investment report

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

3.9 Policy on the use of external service providers

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.

Appendices

1. Interest rate forecasts
2. Economic background
3. Treasury Management practice - Specified and non specified investments and limits

APPENDIX 1 - Interest Rate Forecast 2011/2015

Sector's Interest Rate View	Now	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Sector's Bank Rate View	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
3 Month LIBID	**0.87%**	0.70%	0.70%	0.70%	0.70%	0.70%	0.75%	0.80%	0.90%	1.20%	1.40%	1.60%	2.10%	2.40%	2.60%
6 Month LIBID	**1.16%**	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.20%	1.40%	1.60%	1.80%	2.00%	2.50%	2.70%	2.90%
12 Month LIBID	**1.65%**	1.50%	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.20%	2.40%	2.60%	3.10%	3.20%	3.30%
5yr PWLB Rate	**2.25%**	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
10yr PWLB Rate	**3.33%**	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
25yr PWLB Rate	**4.24%**	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
50yr PWLB Rate	**4.26%**	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
Bank Rate															
Sector's View	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
UBS	**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%	0.50%	-	-	-	-	-
5yr PWLB Rate															
Sector's View	**2.25%**	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
UBS	**2.25%**	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	**2.25%**	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	-	-	-	-	-
10yr PWLB Rate															
Sector's View	**3.33%**	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
UBS	**3.33%**	3.45%	3.45%	3.50%	3.60%	3.65%	-	-	-	-	-	-	-	-	-
Capital Economics	**3.33%**	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	-	-	-	-	-
25yr PWLB Rate															
Sector's View	**4.24%**	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
UBS	**4.24%**	4.80%	4.90%	4.90%	4.90%	4.90%	-	-	-	-	-	-	-	-	-
Capital Economics	**4.24%**	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	-	-	-	-	-
50yr PWLB Rate															
Sector's View	**4.26%**	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
UBS	**4.26%**	4.80%	4.95%	4.95%	5.00%	5.00%	-	-	-	-	-	-	-	-	-
Capital Economics	**4.26%**	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	-	-	-	-	-

APPENDIX 2 Economic Background

The Council's treasury management advisers have provided the following view of the economy for the forthcoming financial year:

4.1. Global economy

The outlook for the global economy remains clouded with uncertainty with the UK economy struggling to generate sustained recovery that offers any optimistim for the outlooks for 2011 and 2012, or possibly even into 2013. Consumer and business confidence levels are low and with little to boost sentiment, it is not easy to see potential for a significant increase in the growth rate in the short term.

At the centre of much of the uncertainty is the ongoing **Eurozone sovereign debt crisis** which has intensified, rather than dissipated throughout 2011. The main problem has been **Greece**, where, even with an Eurozone/IMF/ECB bailout package and the imposition of austerity measures aimed at deficit reduction, the lack of progress and the ongoing deficiency in addressing the underlying lack of competitiveness of the Greek economy, has seen an escalation of their problems. These look certain to result in a default of some kind but it currently remains unresolved if this will be either "orderly" or "disorderly", and/or also include exit from the €uro bloc.

As if that were not enough there is growing concern about the situation in **Italy** and the risk that contagion has not been contained. Italy is the third biggest debtor country in the world but its prospects are limited given the poor rate of economic growth over the last decade and the lack of political will to address the need for fundamental reforms in the economy. The Eurozone now has a well established track record of always doing too little too late to deal with this crisis; this augurs poorly for future prospects, especially given the rising level of electoral opposition in northern EU countries to bailing out profligate southern countries.

The US economy offers little to lift spirits. With the next Presidential elections due in November 2012, the current administration has been hamstrung by political gridlock with the two houses split between the main parties. In quarter 3 the Federal Reserve started "Operation Twist" in an effort to re-ignite the economy in which growth is stalling. High levels of consumer indebtedness, unemployment and a moribund housing market are weighing heavily on consumer confidence and so on the abiltity to generate sustained economic growth.

Hopes for broad based recovery have, therefore, focussed on the **emerging markets** but these areas have been struggling with inflationary pressures in their previously fast growth economies. China, though, has maintained its growth pattern, despite tightening monetary policy to suppress inflationary pressures, but some forward looking indicators are causing concern that there may not be a soft landing ahead, which would then be a further dampener on world economic growth.

4.2 UK economy

The Government's austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy. However, coming at a time when economic growth has virtually flatlined and concerns at the risk of a technical recession (two quarters of negatibe growth) in 2012, it looks likely that the private sector will not make up for the negative impact of these austerity measures given the lack of an export led recovery due to the downturn in our major trading partner – the EU. The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth. GDP growth has, basically, flatlined since the election of 2010 and, worryingly, the economic forcecasts for 2011 and 2012 have been revised lower on a near quarterly basis as the UK recovery has, effectively, stalled. With fears of a potential return to recession the Bank of England embarked on a second round of Quantitive Easing to stimulate economic activity.

Unemployment. With the impact of the Government's austerity strategy impacting the trend for 2011 of steadily increasing unemployment, there are limited prospects for any improvement in 2012 given the deterioration of growth prospects.

Inflation and Bank Rate. For the last two years, the MPC's contention has been that high inflation was the outcome of temporary external factors and other one offs (e.g. changes in VAT); that view remains in place with CPI inflation standing at 5.2% at the start of quarter 4 2011. They remain of the view that the rate will fall back to, or below, the 2% target level within the two year horizon.

AAA rating. The ratings agencies have recently reaffirmed the UK's AAA sovereign rating and have expressed satisfaction with Government policy at deficit reduction. They have, though, warned that this could be reviewed if the policy were to change, or was seen to be failing to achieve its desired outcome. This credit position has ensured that the UK government is able to fund itself at historically low levels and with the safe haven status from Eurozone debt also drawing in external investment the pressure on rates has been down, and looks set to remain so for some time.

4.3 The view of the Treasury Consultants

Economic forecasting remains troublesome with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there is still a broad range of views as to potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:

- a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
- 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 inceasingly seem likely to be undershot;
- a continuation of high levels of inflation ;
- 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, Germany and France in 2012 or 2013;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

The overall balance of risks remains weighted to the downside. Lack of economic growth, both domestically and overseas, will impact on confidence putting upward pressure on unemployment. It will also further knock levels of demand which will bring the threat of recession back into focus.

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 mid-2013 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

APPENDIX 3 - Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management Specified and Non-Specified Investments and Limits

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of £5m will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

- The criteria in this appendix are intended to be the operational criteria in normal times. At times of heightened volatility, risk and concern in financial markets, this strategy may be amended by temporary operational criteria further limiting investments to counterparties of a higher creditworthiness and / or restricted time limits

	*** Minimum credit criteria / colour band**	**** Max % of total investments/ £ limit per institution**	**Max. maturity period**
DMADF – UK Government	N/A	unlimited	6 months
UK Government gilts	AAA	N/A	XX years
UK Government Treasury blls	AAA	N/A	XX years
Bonds issued by multilateral development banks	AAA	N/A	6 months
Money market funds	AAA	£3m per fund	Liquid
Local authorities	N/A	£2m per local authority	

Term deposits with banks and building societies (includes part nationalised institutions)	Yellow Purple Blue Orange Red Green No Colour	£2m per institution	Up to 5 years Up to 2 years Up to I year Up to 1 year Up to 6 Months Up to 3 months Not for use
CDs or corporate bonds with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	N/A	Up to 5 years Up to 2 years Up to I year Up to 1 year Up to 6 Months Up to 3 months Not for use
Corporate bond funds		N/A	
Gilt funds	AAA	N/A	

Note:

The lowest colour band that will be used is Yellow i.e. up to 5 years

Specified Investments (under one year) contd

Collateralised deposit (see note 2)	UK sovereign rating or note 1	In-house and Fund Managers
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating or note 1	In-house
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating or * Short-term __, Long-term __, Individual __, Support __	Fund Managers
Certificates of deposit issued by banks and building societies covered by the UK Government banking support package (implicit guarantee)	UK sovereign rating or note 1	In-house
Certificates of deposit issued by banks and building societies covered by the UK Government banking support package (implicit guarantee)	UK sovereign rating or * Short-term __, Long-term __, Individual __, Support __	Fund Managers
Certificates of deposit issued by banks and building societies NOT covered by UK Government support package (implicit guarantee)	See note 1	In-house
Certificates of deposit issued by banks and building societies NOT covered by UK Government guarantee support package (implicit guarantee)	*Short-term __, Long-term __, Individual __, Support __	Fund Managers
UK Government Gilts	UK sovereign rating	In-house buy and hold and Fund Managers
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	In-house buy and hold and Fund Managers

Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	In-house buy and hold and Fund Managers
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	In-house buy and hold and Fund Managers
Treasury Bills	UK sovereign rating	In house and Fund Managers

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Government Liquidity Funds	Long-term __ volatility rating	In-house and Fund Managers
2. Money Market Funds	Long-term __ volatility rating	In-house and Fund Managers
3. Enhanced cash funds	Long-term __ volatility rating	In-house and Fund Managers
4. Gilt Funds	Long-term __ volatility rating	In-house and Fund Managers

Note 1. The lowest colour band that will be used is Yellow.

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

Note 2. as collateralised deposits are backed by collateral of AAA rated local authority LOBOs, this investment instrument is regarded as being a AAA rated investment as it is equivalent to lending to a local authority.

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

NON-SPECIFIED INVESTMENTS: A maximum of £5m will be held in aggregate in non-specified investment

1. Maturities of ANY period

	*** Minimum Credit Criteria**	**Use**	**** Max % of total investments/ £ limit per institution**	**Max. maturity period**
Fixed term deposits with variable rate and variable maturities: -Structured deposits	Yellow colour band	In-house	£1m per institution	Up to 5 years
Term deposits with unrated counterparties : any maturity	** state alternative to credit criteria*	In-house	N/A	
Commercial paper issuance covered by a specific UK Government (explicit) guarantee and issued by banks covered by the UK bank support package	UK sovereign rating or note 1	In-house	N/A	
Commercial paper issuance covered by a specific UK Government (explicit) guarantee and issued by banks covered by the UK bank support package	UK sovereign rating or * Short-term __, Long-term __, Individual __, Support __	Fund Managers	N/A	
Commercial paper issuance by UK banks covered by UK Government (implicit) guarantee	UK sovereign rating or note 1	In-house	N/A	
Commercial paper issuance by UK banks covered by UK Government (implicit) guarantee	UK sovereign rating or * Short-term __, Long-term __, Individual __, Support __	Fund Managers	N/A	
Commercial paper other	* Short-term __, Long-term __, Individual __, Support __	In-house	N/A	
Corporate Bonds issuance covered by UK Government (implicit) guarantee and issued by banks covered by the UK bank support package : ***the use of these investments would constitute capital expenditure*** although this is currently under review	UK sovereign rating or * Short-term __, Long-term __, Individual __, Support __	In-house and Fund Managers	N/A	
Corporate Bonds other : ***the use of these investments would constitute capital expenditure*** although this is currently under review.	* Short-term __, Long-term __, Individual __, Support __	In-house and Fund Managers	N/A	
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	UK sovereign rating or * Short-term __, Long-term __, Individual __, Support __	In-house and Fund Managers	N/A	

Floating Rate Notes : ***the use of these investments would constitute capital expenditure (although this is currently under review) unless they are issued by a multi lateral development bank***	* Long-term __,	Fund Managers	N/A	
Property fund: ***the use of these investments would constitute capital expenditure***	--	In house and Fund Managers	N/A	

Note 1. The lowest colour band that will be used is Yellow

2. Maturities in excess of 1 year

	*** Minimum Credit Criteria**	**Use**	**** Max % of total investments/ £ limit per institution**	**Max. maturity period**
Term deposits – local authorities	--	In-house	£1m per local authority	
Term deposits – banks and building societies	Yellow colour band	In-house	£1m per institution	5 years
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating or note 1	In-house	N/A	
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating or * Short-term __, Long-term __, Individual __, Support __	Fund Managers	N/A	
Certificates of deposit issued by banks and building societies covered by the UK Government banking support package (implicit guarantee)	UK sovereign rating or note 1	In-house	N/A	
Certificates of deposit issued by banks and building societies covered by the UK Government banking support package (implicit guarantee)	UK sovereign rating or * Short-term __, Long-term __, Individual __, Support __	Fund Managers	N/A	
Certificates of deposit issued by banks and building societies NOT covered by UK Government support package (implicit guarantee)	See note 1	In-house	N/A	
Certificates of deposit issued by banks and building societies NOT covered by UK Government guarantee support package (implicit guarantee)	*Short-term __, Long-term __, Individual __, Support __	Fund Managers	N/A	
UK Government Gilts	UK sovereign rating	In-house and Fund Managers	N/A	
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	In-house and Fund Managers	N/A	

Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	In-house and Fund Managers	N/A	
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
1. Bond Funds	* Long-term __ volatility rating	In-house and Fund Managers	N/A	
2. Gilt Funds	* Long-term __ volatility rating	In-house and Fund Managers	N/A	

Note 1. The lowest colour band to be used is Yellow