Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2013-14

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 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."*

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.

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 Council's needs or whether any policies require revision.

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

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Budget & Strategeic Planning Working Group .

1.3 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.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This has previously been undertaken by the Council's treasury consultants. The training needs of treasury management officers are periodically reviewed.

1.5 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.

2 THE CAPITAL PRUDENTIAL INDICATORS 2013/14 – 2015/16

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.

2.1 Capital expenditure

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

Capital expenditure	2011/12 Actual £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Non-HRA	3,225	6,107	1,348	2,351	2,334
HRA	28,982	1,803	1,601	2,351	2,398
Total	32,207	7,910	2,949	4,702	4,732
Financed by:					
Capital receipts	803	4,899	1,030	1,751	1,751
Capital grants	140	710	495	100	100
Capital reserves	3,642	2,241	1,392	2,480	2,510
Revenue	0	60	32	371	371
Net financing need for the year	**27,622**	**0**	**0**	**0**	**0**

2.2 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.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life. However, the authority's allowable debt gained from its RTB receipts over that within the settlement will reduce the HRA CFR

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase 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 £0.189m of such schemes within the CFR in 2011/12.

The Council is asked to approve the CFR projections below:

	2011/12 Actual £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Capital Financing Requirement					
CFR – non housing	189	176	163	151	138
CFR – housing	**31,904**	**31,828**	**31,805**	**31,404**	**31,395**
Total CFR	**32,093**	**32,004**	**31,968**	**31,555**	**31,533**
Movement in CFR	**22,500**	**-89**	**-36**	**-413**	**-22**

Movement in CFR represented by					
Net financing need for the year (above)	27,622	0	0	0	0
Less MRP/VRP and other financing movements	-5,122	-27	-27	-404	-13
Allowable RTB receipts	0	-62	-9	-9	-9
Movement in CFR	**22,500**	**-89**	**-36**	**-413**	**-22**

2.3 Minimum revenue provision (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:

From 1 April 2013 for all unsupported borrowing (including PFI and finance leases) the MRP policy will continue to 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.

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.

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.

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

2.4 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:

2.5 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.

	2011/12 Actual %	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %
Non-HRA	4.88	-1.12	-0.72	-0.46	-0.84
HRA	3.07	16.39	15.94	14.93	14.05

The estimates of financing costs include current commitments and the proposals in this budget report. The changes to the Non HRA ratio from 2012/13 onwards are the result of the repayment of GF debt in 2011/12. The variations between years thereafter are primarily the result of changes in the predicted levels of investment income in the relevant years.

For HRA the increase in 2012/13 is due to the interest costs associated with the introduction of HRA reform debt and reductions thereafter relate to predicted increases in rent levels as no new borrowing is expected and small borrowing reduction in 2015.

2.6 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 Actual £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £
Council tax - band D	0.00	0.00	-10.03	-20.02	-14.48

The figures shown from 2013/14 onwards reflects savings arising out of reductions to the level of payments to the Waterfield Leisure Centre contractors associated with the refurbishment programme and savings which will arise from the Transformation Change programme.

2.7 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 Actual £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £
Weekly housing rent levels	0.00	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 Borrowing

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 2012, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2011/12 Actual £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
External Debt					
Debt at 1 April	6,988	31,861	31,861	31,861	31,413
Expected change in Debt	24,873	0	0	-448	0
Other long-term liabilities (OLTL)	221	215	177	164	151
Expected change in OLTL	-6	-38	-13	-13	-13
Actual gross debt at 31 March	**31,861**	**31,861**	**31,861**	**31,413**	**31,413**
The Capital Financing Requirement	**32,093**	**32,004**	**31,968**	**31,555**	**31,533**
Under / (over) borrowing	**232**	**143**	**107**	**142**	**120**

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 gross debt 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. 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 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	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Debt	34,861	34,861	34,413	34,413
Other long term liabilities	177	164	151	138
Total	35,038	35,025	34,564	34,551

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.

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 limit:

Authorised limit	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000	2015/16 Estimate £000
Debt	44,820	44,840	44,850	44,860
Other long term liabilities	180	160	150	140
Total	45,000	45,000	45,000	45,000

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	33,554	33,554	33,554	33,554

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. The following table gives their central view along with their view on the economy moving forward.

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	3.80	4.00
June 2013	0.50	1.50	3.80	4.00
Sept 2013	0.50	1.60	3.80	4.00
Dec 2013	0.50	1.60	3.80	4.00
March 2014	0.50	1.70	3.90	4.10
June 2014	0.50	1.70	3.90	4.10
Sept 2014	0.50	1.80	4.00	4.20
Dec 2014	0.50	2.00	4.10	4.30
March 2015	0.75	2.20	4.30	4.50

The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the economy did come out of recession in the third quarter of 2012. Growth prospects are weak and consumer spending the usual 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.

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.

This challenging and uncertain economic outlook has several key treasury mangement 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.

3.3 Borrowing strategy

All borrowing is currently, and will be for the foreseeable future attributable to the HRA. 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 relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2013/14 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, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- 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.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

The Council has total HRA borrowing of £31.86m at an average interest rate of 3.68% for periods ranging from 30years to 50 years; this is a particularly low rate of borrowing.

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:

	2013/14 £m	2014/15 £m	2015/16 £m
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	37	38	38
Limits on variable interest rates based on net debt	8	7	7
Maturity structure of fixed interest rate borrowing 2013/14			
		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 2013/14		
	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%

3.4 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.

3.5 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

4 ANNUAL INVESTMENT STRATEGY

4.1 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 and then return.

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.

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.

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.

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.

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.

4.2 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.

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:

- 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; please also see collateralised deposits added into appendix 3 as an investment instrument.

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.

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.

All credit ratings will be monitored on a regular basis. 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.

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.

The Local Authority Mortgage Scheme (LAMS) – The Council is currently particpating 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.

4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *AA-* from Fitch (or equivalent counterparty rating). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 4.

This list will be added to, or deducted from, by officers should ratings change in accordance with this policy. The Sector Weekly Counterparty list is produced on this basis.

The UK currently has an AAA sovereign rating and it is possible that this rating could in the future be downgraded by one, or more, rating agencies. It is therefore advisable that the Council consider NOT setting a minimum sovereign rating of AAA so as to ensure continuity of being able to invest in UK banks if such a downgrading were to occur.

4.4 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 4 of 2014. 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%

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.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next four years are as follows:

2012/13	0.50%
2013/14	0.50%
2014/15	0.60%
2015/16	1.50%

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			
£m	**2013/14**	**2014/15**	**2015/16**
Principal sums invested > 364 days	£5m	£5m	£5m

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.

4.5 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 - £0.5m
- Liquid short term deposits of at least £0.25m 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 7day 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.

4.6 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.

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Appendices

1. Interest rate forecasts
2. Economic background
3. Treasury management practice – credit and counterparty risk management
4. Approved countries for investments

APPENDIX 1-: Interest Rate Forecasts 2013 - 2015

Sector's Interest Rate View											
	Now	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%	0.50%	0.75%	1.00%
3 Month LIBID	0.40%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.70%	0.90%	1.10%	1.40%
6 Month LIBID	0.58%	0.85%	0.85%	0.85%	0.85%	0.85%	1.00%	1.10%	1.30%	1.50%	1.80%
12 Month LIBID	0.97%	1.30%	1.30%	1.30%	1.40%	1.50%	1.70%	1.90%	2.10%	2.30%	2.60%
5yr PWLB Rate	1.66%	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.30%
10yr PWLB Rate	2.67%	2.50%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.20%	3.30%
25yr PWLB Rate	3.88%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%
50yr PWLB Rate	4.03%	3.90%	3.90%	3.90%	4.00%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%
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%
UBS	0.50%	0.25%	0.25%	0.25%	0.25%	0.25%	-	-	-	-	-
Capital Economics	0.50%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	-
5yr PWLB Rate											
Sector's View	1.66%	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.30%
UBS	1.66%	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.66%	1.20%	1.20%	1.20%	1.20%	1.20%	1.20%	1.30%	1.40%	1.50%	-
10yr PWLB Rate											
Sector's View	2.67%	2.50%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.20%	3.30%
UBS	2.67%	2.80%	3.00%	3.10%	3.20%	3.40%	-	-	-	-	-
Capital Economics	2.67%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-
25yr PWLB Rate											
Sector's View	3.88%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%
UBS	3.88%	4.00%	4.20%	4.30%	4.40%	4.50%	-	-	-	-	-
Capital Economics	3.88%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-
50yr PWLB Rate											
Sector's View	4.03%	3.90%	3.90%	3.90%	4.00%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%
UBS	4.03%	4.00%	4.20%	4.30%	4.40%	4.50%	-	-	-	-	-
Capital Economics	4.03%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-

APPENDIX 2-: Economic Background

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

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.

The view of the Treasury consultants

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.

APPENDIX 3- : Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

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	UK sovereign rating	N/A	XX years
UK Government Treasury blls	UK sovereign rating	N/A	XX years
Bonds issued by multilateral development banks	UK sovereign rating	N/A	6 months
Money market funds	AAA	£3m per fund	Liquid
Local authorities	N/A	£2m per local authority	
Nationalised and part nationalised banks ie. Lloyds /RBS banking group	Blue	£4m per banking group	Up to 1 year

Term deposits with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	£2m per institution	Up to 5 years Up to 2 years Up to 1 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 1 year Up to 1 year Up to 6 Months Up to 3 months Not for use
Corporate bond funds		N/A	
Gilt funds	UK sovereign rating	N/A	
Property funds			
Local Authority Mortgage Scheme. Under this scheme the Council is required to place funds of £1m, with a financial institution for a 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.			

NOTE:

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

Specified Investments (under one year) cont'd

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 __, Viability __, 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**	**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	UK sovereign rating or note 1	In-house	N/A	
Commercial paper issuance covered by a specific UK Government (explicit) guarantee	UK sovereign rating or * Short-term __, Long-term __, Viability __, Support __	Fund Managers	N/A	
Commercial paper other	* Short-term __, Long-term __, Viability __, Support __	In-house	N/A	
Corporate bonds	* Short-term __, Long-term __, Viability __, 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 __, Viability __, Support __	In-house and Fund Managers	N/A	
Floating rate notes	* 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	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 __, Viability __, Support __	Fund Managers	N/A	
Certificates of deposit issued by banks and building societies	See note 1	In-house	N/A	
Certificates of deposit issued by banks and building societies e	*Short-term __, Long-term __, Viability __, 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 that will be used is Yello*w*

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APPENDIX 4-: Approved countries for investments

Based on lowest available rating (see 4.3-Country limits)

AAA
- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.

AA+
- France
- Hong Kong
- U.S.A.

AA
- Abu Dhabi
- Qatar
- UAE

AA-
- Belgium
- Japan
- Saudi Arabia