Agenda Item No: 6

Report to: Budget Cabinet

Date of Meeting: 17 February 2014

Report Title: Treasury Management and Annual Investment Strategy 2014/15, including Quarterly Monitoring Reports for 2013/14

Report By: Peter Grace
Head of Finance

Purpose of Report

To consider the draft Treasury Management and Annual Investment Strategy and draw any concerns or recommendations to Council as appropriate, to ensure that there is an effective framework for the management of the Council's investments, cash flows and borrowing activities. The Council has £11.5 million of debt, and investments which can fluctuate between £15million and £28 million during the year.

There is a statutory requirement to determine, by full Council, the Treasury Management Strategy Statement, Minimum Revenue Provision (MRP) Policy and Annual Investment Strategy (2014/15) prior to the start of the new financial year.

Recommendation(s)

1. **The Cabinet recommend that the Council approve the Treasury Management Strategy, Minimum Revenue Provision (MRP) Policy and Annual Investment Strategy (2014/15)**

Reasons for Recommendations

The Council seeks to minimise the costs of borrowing and maximise investment income whilst ensuring the security of its investments. The sums involved are large and the assumptions made play an important part in determining the annual budget. Compliance with the CIPFA Code of Practice represents best practice and ensures compliance with statutory requirements.

Introduction

1. The CIPFA Code of Practice on Treasury Management has been adopted by this Council and its requirements and subsequent revisions are fully complied with.

2. The purpose and requirements of the Code are identified as Appendix 8.

3. Treasury management in this context is defined as:

   "The management of the 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"

4. The Council maintains detailed Treasury Management Practices (TMPS), which are determined by the Chief Finance Officer and kept under regular review. These ensure effective day to day management of Treasury management activities.

5. The reporting arrangements proposed, in accordance with the requirements of the revised Code, are summarised below:-

Area of Responsibility	Council/ Committee/ Officer	Frequency
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Cabinet and Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Cabinet and Council	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Cabinet and Council	As required
Annual Treasury Outturn Report	Cabinet and Council	Annually by 30 September after the end of the year
Treasury Management Practices	S151 Officer	Reviewed as required (minimum - annually)
Scrutiny of Treasury Management Strategy	Audit Committee	Annually before the start of the year
Scrutiny of treasury management performance and strategy	Audit Committee	Quarterly Monitoring reports, Mid Year report,

6. The Council is required to determine the Prudential Indicators as part of the Treasury Management Strategy; these are identified in Appendix 3.

7. The Audit Committee considered the report at its meeting on the 15th January 2014 and made no recommendations to amend the strategy and policies.

Investment Performance 2013-14

8. The performance for the first 6 months of 2013/14 provided an average return of 1.05% (excludes Local Authority Mortgage (LAM) scheme).This compares to 1.55% for the same period last year. The government's Funding for Lending Scheme has seen the interest rates on offer to local authorities diminish significantly over the last 12 months. The Council has in the past been able to take advantage of the special rates on offer to Councils e.g. the opportunity was taken in April 2012 to invest £5m for a year at a rate of 3.0% and an opportunity to invest £5 million in August 2012 at 2.4% the comparable rates at the end of September are between 0.8% and 1%.

9. The total interest for the first 6 months is £127,000 (excluding Local Authority Mortgage Scheme). This compares to £140,000 for the same period last year.

10. All treasury management indicators e.g. borrowing limits have been adhered to during the year to date.

Treasury Management Strategy for 2014/15

11. The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

12. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

13. The suggested strategy for 2014/15 in respect of the following aspects of the treasury management function is based upon the Council officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Capita Asset Services (previously Sector).

14. The strategy covers:

    a. treasury limits in force which will limit the treasury risk and activities of the Council

    b. Prudential and Treasury Indicators

    c. the current treasury position

    d. the borrowing requirement

    e. prospects for interest rates

    f. the borrowing strategy

    g. policy on borrowing in advance of need

    h. debt rescheduling

    i. the investment strategy

j. creditworthiness policy
k. policy on use of external service providers
l. the MRP strategy

The key changes from the previous year's strategy are:

(i) Investment returns are expected to be lower in 2014/15 (0.75% estimated) than for 2013/14 (1% estimated).

Balanced Budget

15. It is a statutory requirement under the Local Government Finance Act 1992, for the Council to calculate its Council Tax requirement. In particular, Section 31 requires a local authority in calculating the Council Tax requirement for each financial year to include the revenue costs that flow from capital financing decisions. Thus any increases in costs (running costs & borrowing costs) from new capital projects must be limited to a level which is affordable within the projected income of the Council for the foreseeable future.

TREASURY LIMITS FOR 2014/15 TO 2016/17

16. The treasury indicators for borrowing activity are the Operational Boundary and the Authorised Limit for external debt.

17. The Operational Boundary is the limit beyond which external debt is not normally expected to exceed.

18. The Authorised Limit, which is a limit beyond which external debt is prohibited, needs to be set or revised by the full Council, it is a statutory duty under Section 3 of the Act and supporting regulations. Essentially the Council is required to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future Council Tax levels is 'acceptable'.

19. Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements (certain leases). The Authorised Limit and operational boundary are to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

20. Another key indicator is the CFR (Capital Financing Requirement). 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 which has not been funded from grants, revenue, reserves or capital receipts will increase the CFR.

21. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) reduces the balance.

22. The Council needs to ensure that its total debt does not exceed the CFR.

PRUDENTIAL AND TREASURY INDICATORS FOR 2013/14 TO 2016/17

23. Prudential Indicators (as set out in appendix 3 to this report) are relevant for the purposes of setting an integrated treasury management strategy.

CURRENT PORTFOLIO POSITION

24. The Council's treasury portfolio position at 30 November 2013 comprised:

Table 1 **Debt**	31 March 2013 Principal	Rate	Maturity	30 November 2013 Principal	Rate
PWLB Loan 1	£7.5m	4.80%	2033	£7.5m	4.80%
PWLB Loan 2	£1.0m	2.02%	2016	£1.0m	2.02%
PWLB Loan 3	£1.0m	1.63%	2018	£1.0m	1.63%
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	£9.5m			£9.5m	
PWLB Loan 4	£2.0m	0.56% (Variable Rate)	2019	£2.0m	0.57% (Variable Rate*)
Total Debt	£11.5m	3.89%		£11.5m	3.89%

* rate at 29th October (rates change every 3 months)
** PWLB - Public Works Loan Board

BORROWING REQUIREMENT

25. Our long term borrowing will need to be determined by the relative merits of using alternative funding sources, including the reduction of investments, based on an assessment of market conditions as set out in the borrowing strategy below. Borrowing will not exceed the figures set out in the Prudential Indicators.

PROSPECTS FOR INTEREST RATES

26. The Council has appointed Capita Asset Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates (Appendix 2).

27. Capita Asset Services' bank base rate forecast for financial year ends (March) is:-

- 2013/14 0.50%
- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 1.25%

28. Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded in 2013 - quarter 1 (+0.3%), 2 (+0.7%) and 3 (+0.8%), to surpass all expectations as all three main sectors, services, manufacturing and construction contributed to this strong upturn.

The Bank of England upgraded growth forecasts in the August and November quarterly Inflation Reports for 2013 from 1.2% to 1.6% and for 2014 from 1.7% to 2.8%, (2015 unchanged at 2.3%).

29. The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Euozone so the difficulties in this area may continue to hinder UK growth.

30. This challenging and uncertain economic outlook has several key treasury management implications:

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2014/15 and for a period beyond;
- Borrowing interest rates continue to be attractive and may remain relatively low until late 2014/15. 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.

31. A detailed view of the current economic background by Capita Asset services is contained within Appendix 4 to this report.

BORROWING STRATEGY

32. The Council again registered for the certainty rate earlier in the year which has given a 20 basis point reduction in the average rate of borrowing. The Capita forecast for the Public Works Loan Board (PWLB) new borrowing rate is as follows:-

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2013	0.50	2.50	4.40	4.40
Mar 2014	0.50	2.50	4.40	4.40
Jun 2014	0.50	2.60	4.50	4.50
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.60	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.10	5.00	5.10
Jun 2016	0.75	3.20	5.10	5.20
Sep 2016	1.00	3.30	5.10	5.20
Dec 2016	1.00	3.40	5.10	5.20
Mar 2017	1.25	3.40	5.10	5.20

33. In view of the above forecast the Council's borrowing strategy will be based upon the following information.

    a. The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against the potential increase in long term costs should rates be higher in future years.
    b. The use of PWLB variable rate loans for up to 10 years
    c. The use of long term fixed rate market loans should rates be below PWLB rates for the equivalent maturity period.
    d. PWLB borrowing for periods under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt.
    e. Preference will be given to PWLB borrowing by maturity loans
    f. Rates are expected to gradually increase during next year. The Council need to be alert to opportunities particularly at the start of the year.

34. Sensitivity of the forecast – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

    a. if it were 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

    b. if it were 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.

External versus Internal Borrowing

Comparison of gross and net debt positions at year end	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	Estimated out-turn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
External debt (gross) at 1st April	11,500	11,500	15,120	15,120	15,120
Expected change in debt	0	3,620	0	0	0
Other Long term liabilities at 1st April	0	0	0	0	0
Actual Gross Debt at 31st March	11,500	15,120	15,120	15,120	15,120
CFR	16,944	20,061	19,541	19,021	18,501
Internal Borrowing - Under/(Over) borrowed	5,444	4,941	4,421	3,901	3,381

35. The additional new borrowing in 2013/14 results from the Coastal Space project in partnership with Amicus Horizon. A new loan for a 30 year period being secured to match the agreement period with Amicus Horizon and provide greater certainty on the financial viability of the scheme – particularly in respect of the £2.4m loan to Amicus Horizon (Amicus Horizon meet the interest and principal repayments).

36. This Council currently anticipates to be under borrowed by £4.9million at 31 March 2014. This means the Council could effectively increase its borrowing by £4.9 million and still be within prudential limits.

37. The general aim of this treasury management strategy is to reduce the costs of borrowing in both the short and longer term. In the short term it can consider avoiding new borrowing and using cash balances to finance new borrowing. However to minimise longer term costs it needs to borrow when rates are a historically low levels. The timing of new borrowing is therefore important to minimise the overall costs to the Council.

38. Over the next two to three years, investment rates are expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

39. However, short term savings by avoiding new long term external borrowing in 2014/15 will also be weighed against the potential for incurring additional long term extra costs by delaying new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.

40. 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 2014/15 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.

41. The Council is currently maintaining an under-borrowed position as identified above. 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.

42. Against this background caution will be adopted with the 2014/15 treasury operations.

Policy on borrowing in advance of need

43. 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 considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

44. In determining whether borrowing will be undertaken in advance of need the Council will:

    a. ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
    b. ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
    c. evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
    d. consider the merits and demerits of alternative forms of funding.
    e. consider the appropriate funding period.
    f. consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and the level of such risks given the controls in place to minimise them.

DEBT RESCHEDULING

45. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be

incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing.

46. As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential for some residual 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 size of premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a flattening of the Council's maturity profile as in recent years there has been a skew towards longer dated PWLB.

47. The reasons for any rescheduling to take place will include:

    a. the generation of cash savings and / or discounted cash flow savings,
    b. helping to fulfil the strategy outlined above
    c. enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Minimum Revenue Provision (MRP)

48. Appendix 1 of this report provides the detail on what the MRP is and the basis of the calculation. Basically, authorities are required each year to set aside some of their revenues as provision for debt repayment. Unlike depreciation which is reversed out of the accounts, this provision has a direct impact on the Council Tax requirement. The provision is in respect of capital expenditure that is financed by borrowing or credit arrangements e.g. leases.

49. The Council is required to make a "Prudent Provision" which basically ensures that revenue monies are set aside to repay the debt over the useful life of the asset acquired i.e. the Minimum Revenue Provision (MRP). The MRP for 2014/15 is estimated at £520,000 (the statutory charge to revenue that remains within the accounts).

ANNUAL INVESTMENT STRATEGY

Investment Policy

50. The Council will have regard to the government'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 are: -

    a. the security of capital and
    b. the liquidity of its investments.

51. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

52. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

53. Investment instruments identified for use in the financial year are listed in Appendix 5 under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices – Schedules.

54. 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 Capita ratings, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

55. 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, Capita in producing its colour codings which show the varying degrees of suggested creditworthiness.

Creditworthiness Policy

56. This Council uses the creditworthiness service provided by Capita Asset Services. This service has been progressively enhanced over the last couple of years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody’s and Standard and Poor’s, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

57. 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 code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service

now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

58. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands: -

- Purple 2 years (but HBC will only invest for up to 1 year – except LAMS)
- 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

59. This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moody's tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Capita creditworthiness service does though, use ratings from all three agencies, but by using a risk based scoring system, does not give undue weighting to just one agency's ratings.

60. The Council is alerted to the changes to Credit ratings of all three agencies through its use of the Capita creditworthiness service. These are monitored on a daily basis with lists updated weekly by Capita Asset Services.

61. 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.

62. The Council only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This is a change from 2013/14 when the minimum criteria was AA+. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy. The maximum investment in any non UK country is not to exceed £10m.

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

Investment Strategy

The table below provides a snapshot of where the investments are placed (as at 30 September 2013). The level varies daily.

Table	Rate/ Return	Start Date	End Date	Principal	Term
Counter Party					
Nat. West	0.60%	21/08/2013		£5.0m	On call 90 days
Nationwide	0.52%	16/04/2013	16/10/2013	£3.0m	Fixed
NAB	0.49%	16/07/2013	12/02/2014	£5.0m	Fixed
Credit Industriel et Commercial	0.52%	16/07/2013	16/10/2013	£3.0m	Fixed
Barclays Bank plc	0.65%	25/04/2012		£2.233m	On Call
Lloyds - Lams 1	4.45%	05/01/2012	10/01/2017	£1.0m	Fixed
Lloyds - Lams 2	1.97%	26/03/2013	26/03/2018	£1.0m	Fixed
Lloyds 1 year fixed	1.10%	11/04/2013	11/04/2014	£5.0m	Fixed
Total				£25.23m	

The year end balance is expected to be in the region of £17m.

64. The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile (up to 1 year) and within the risk parameters set by this council.

65. For 2013/14 the Council's revised budget estimates an investment interest return of 1.0%, and in 2014/15 the return is budgeted at 0.75%.

66. For its cash flow generated balances, the Council will seek to use Business Reserve accounts, 15 and 30 day accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

End of year investment report

67. At the end of the financial year, officers will report to Council on its investment activity as part of its Annual Treasury Report (to be presented by no later than 30 September).

Policy on use of external service providers

68. The Council uses Capita Asset Services (Sector previously) as its external treasury management advisers. There is currently value in employing external providers of treasury management services in order to acquire access to credit worthiness information and specialist advice.

69. The Council's bankers are currently the Coop Bank. They have given notice that they will not be tendering for new contracts in the future and as such the Council will have a different banker as from 1 April 2015 – following a tender exercise. The tender exercise being undertaken in conjunction with other local authorities within East Sussex.

Scheme of delegation

70. Please see Appendix 9.

Role of the Section 151 Officer

71. Please see Appendix 10.

RISK MANAGEMENT

72. The strategy prioritises security of investments over return. Where investments are made they are limited in size and duration. External treasury advisers are used to advise the Council and have been used to train members. The Council has introduced further checks on credit worthiness of counterparties over the last three years as and when these have been further developed by its advisers.

73. Whilst there is no absolute security for investments made, the Council has limited its investments to the higher rated institutions, in order to mitigate the risk as far as practical and looks to reduce the risk by spreading its investment portfolio. The Council has adopted the CIPFA Code of Practice.

74. The inclusion within the investment strategy for the use of Certificates of Deposit enables the Council to invest in institutions that it would otherwise not have access to. This also enables the Council to move money away from the Eurozone should credit ratings drop significantly or look likely to do so.

ECONOMIC/FINANCIAL IMPLICATIONS

75. The Council generally has investments in the year of between £15m and £28m at any one time, and is estimated to have longer term borrowings of £15.2m by the end of March 2014. It has a gross budget of some £83 million and the management of its investments, borrowing and cash flow remains crucial to the proper and effective management of the Council. The Strategies and Policies detailed in the report directly influence the Council's Medium Term Financial Strategy and the annual budget.

ORGANISATIONAL CONSEQUENCES

76. The Cabinet is responsible for the development and review of the Treasury Management Strategy, The Minimum Revenue Provision (MRP) Policy and the Investment Strategy. The Audit Committee is responsible for scrutinising these strategies, policies and performance throughout the year. Full Council, as the budget setting body, remains responsible for the approval of the Treasury Management Strategy, MRP Policy, and Investment Strategy.

77. Monitoring reports will be produced and will be presented to Cabinet and the Audit Committee. A mid year report is presented to full Council on any concerns arising since approving the initial strategies and policies. Only Full Council will be able to amend the Treasury Management Strategy, MRP Policy or Investment Strategy. The Chief Finance Officer will determine the Treasury Management Practices and associated schedules.

Wards Affected

None

Area(s) Affected

None

Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	Yes
Local People's Views	No

Background Information

Supporting Documents
APPENDICES
1. MRP Introduction and Policy Statement
2. Interest Rate Forecasts
3. Prudential and Treasury indicators
4. Economic Background
5. Specified and non specified investments
6. Approved countries for investments
7. Treasury Management Policy Statement
8. Purpose and requirements of the code
9. Treasury management scheme of delegation
10. The treasury management role of the section 151 officer

Other Supporting Documents:-
CIPFA - Treasury Management Code of Practice (Revised 2011)
CIPFA - The Prudential Code (Revised second edition 2011)

Officer to Contact

Peter Grace
pgrace@hastings.gov.uk
01424 451503

APPENDIX 1

Minimum Revenue Provision – An Introduction

1. What is a Minimum Revenue Provision?
Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

2. Statutory duty
Statutory Instrument 2008 no. 414 s4 lays down that:

“A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent.”

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).

There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

3. Government Guidance
Along with the above duty, the Government issued guidance which came into force on 31st March 2008 which requires that a Statement on the Council’s policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to “have regard” to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to ‘have regard’ to the guidance therefore means that: -

Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Option 1: Regulatory Method
Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for “Adjustment A”) on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the SCE annual allocation.

Option 2: Capital Financing Requirement Method
This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority’s outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method.
This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -
Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an ‘MRP holiday’). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:
equal instalment method – equal annual instalments,
annuity method – annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method
Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

Minimum Revenue Provision Policy Statement 2014/15

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09 , and will assess the MRP for 2014/15 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

A major proportion of the MRP for 2014/15 relates to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 1 of the guidance. Certain expenditure reflected within the debt liability at 31st March 2014 will under delegated powers be subject to MRP under option 3, which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

The Council participates in LAMS using the cash backed option. The mortgage lenders require a 5 year deposit from the local authority to match the 5 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 (5 year) 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 finance leases are applied as MRP.

APPENDIX 2 Interest Rate Forecasts

The data below shows Sectors forecast

Capita Asset Services Interest rate forecast - 2014-2017

Capita Asset Services Interest Rate View														
	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
3 Month LIBID	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.70%	0.90%	1.30%
6 Month LIBID	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.70%	0.80%	1.00%	1.20%	1.40%
12 Month LIBID	0.80%	0.80%	0.80%	0.80%	0.80%	0.80%	0.80%	1.00%	1.20%	1.40%	1.60%	1.80%	2.00%	2.30%
5yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
10yr PWLB Rate	3.60%	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
25yr PWLB Rate	4.40%	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
50yr PWLB Rate	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%
Bank Rate														
Capita Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
UBS	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%	-	-	-	-	-
5yr PWLB Rate														
Capita Asset Services	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
UBS	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	2.10%	2.30%	2.30%	2.30%	2.30%	2.30%	2.50%	2.90%	3.30%	-	-	-	-	-
10yr PWLB Rate														
Capita Asset Services	3.60%	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
UBS	3.90%	4.00%	4.00%	4.10%	4.10%	-	-	-	-	-	-	-	-	-
Capital Economics	3.30%	3.55%	3.55%	3.55%	3.55%	3.55%	3.55%	3.55%	3.80%	-	-	-	-	-
25yr PWLB Rate														
Capita Asset Services	4.40%	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
UBS	4.40%	4.50%	4.50%	4.60%	4.60%	-	-	-	-	-	-	-	-	-
Capital Economics	4.10%	4.20%	4.20%	4.20%	4.20%	4.20%	4.20%	4.20%	4.30%	-	-	-	-	-
50yr PWLB Rate														
Capita Asset Services	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%
UBS	4.50%	4.50%	4.60%	4.60%	4.70%	-	-	-	-	-	-	-	-	-
Capital Economics	4.30%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.50%	-	-	-	-	-

APPENDIX 3 Prudential Indicators

PRUDENTIAL INDICATOR	2012/13	2013/14	2014/15	2015/16	2016/17
(1). EXTRACT FROM BUDGET	£'000	£'000	£'000	£'000	£'000
	Actual	Probable Outturn	Estimate	Estimate	Estimate
Capital Expenditure	£3,650	£7,127	£3,012	£2,021	£ 1,809
Ratio of financing costs to net revenue stream	0.6%	1.2%	1.1%	1.2%	1.3%
Net borrowing requirement (including LAMS)	£1,150	£ 3,620	£0	£0	£0
Capital Financing Requirement as at 31 March	£16,944	£20,061	£19,541	£19,021	£18,501
Annual change in Capital Financing Requirement	£ 421	£ 3,117	- £520	- £520	- £520
Incremental impact of capital investment decisions Increase in council tax (band D) per annum			£3.05	£3.04	£3.03

PRUDENTIAL INDICATOR	2012/13	2013/14	2014/15	2015/16	2016/17
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
borrowing	£20,000	£20,000	£20,000	£20,000	£20,000
other long term liabilities	£10,000	£10,000	£10,000	£10,000	£10,000
TOTAL	£30,000	£30,000	£30,000	£30,000	£30,000
Operational Boundary for external debt -					
borrowing	£20,000	£20,000	£22,000	£22,000	£22,000
other long term liabilities	£10,000	£10,000	£10,000	£10,000	£10,000
TOTAL	£30,000	£30,000	£32,000	£32,000	£32,000

Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments OR:-	100 %	100 %	100 %	100 %	100 %
Upper limit for variable rate exposure Net principal re fixed rate borrowing / investments OR:-	100 %	100 %	100 %	100 %	100 %
Upper limit for total principal sums invested/deposited for over 364 days e.g. LAMS Scheme, Coastal Space	£1,000	£6,000	£6,000	£6,000	£6,000

Maturity structure of fixed rate borrowing during 2014/15	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

APPENDIX 4 Economic Background

THE GLOBAL ECONOMY

The Eurozone (EZ). The sovereign debt crisis has eased during 2013 which has been a year of comparative calm after the hiatus of the Cyprus bailout in the spring. The EZ finally escaped from seven quarters of recession in quarter 2 of 2013 but growth is likely to remain weak and so will dampen UK growth. The ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bail out, has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2012 figures) of 176% Greece, Italy 131%, Portugal 124%, Ireland 123% and Cyprus 110%, remain a cause of concern, especially as many of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are continuing to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US. Greece remains particularly vulnerable and continues to struggle to meet EZ targets for fiscal correction. Many commentators still view a Greek exit from the Euro as inevitable and there are concerns that austerity measures in Cyprus could also end up in forcing an exit. The question remains as to how much damage an exit by one country would do and whether contagion would spread to other countries. However, the longer a Greek exit is delayed, the less are likely to be the repercussions beyond Greece on other countries and on EU banks. It looks increasingly likely that Slovenia will be the next country to need a bailout.

Sentiment in financial markets has improved considerably during 2013 as a result of firm Eurozone commitment to support struggling countries and to keep the Eurozone intact. However, the foundations to this current "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries like Greece and Spain which have unemployment rates of over 26% and unemployment among younger people of over 50%. The Italian political situation is also fraught with difficulties in maintaining a viable coalition which will implement an EZ imposed austerity programme and undertake overdue reforms to government and the economy.

USA. The economy has managed to return to reasonable growth in Q2 2013 of 2.5% y/y and 2.8% in Q3, in spite of the fiscal cliff induced sharp cuts in federal expenditure that kicked in on 1 March, and increases in taxation. The Federal Reserve has continued to provide huge stimulus to the economy through its $85bn per month asset purchases programme of quantitative easing. However, it is expected that this level of support will start to be tapered down early in 2014. It has also pledged not to increase the central rate until unemployment falls to 6.5%; this is probably unlikely to happen until early 2015. Consumer, investor and business confidence levels have improved markedly in 2013. The housing market has turned a corner and house sales and increases in house prices have returned to healthy levels. Many house owners have, therefore, been helped to escape from negative equity and banks have also largely repaired their damaged balance sheets so that they can resume healthy levels of lending. All this portends well for a reasonable growth rate looking forward.

China. Concerns that Chinese growth could be heading downwards have been allayed by recent stronger statistics. There are still concerns around an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also increasing concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan. The initial euphoria generated by "Abenomics", the huge QE operation instituted by the Japanese government to buy Japanese debt, has tempered as the follow through of measures to reform the financial system and the introduction of other economic reforms, appears to have stalled. However, at long last, Japan has seen a return to reasonable growth and positive inflation during 2013 which augurs well for the hopes that Japan can escape from the bog of stagnation and deflation and so help to support world growth. The fiscal challenges though are huge; the gross debt to GDP ratio is about 245% in 2013 while the government is currently running an annual fiscal deficit of around 50% of total government expenditure. Within two years, the central bank will end up purchasing about Y190 trillion (£1,200 billion) of government debt. In addition, the population is ageing due to a low birth rate and will fall from 128m to 100m by 2050.

THE UK ECONOMY

Economic growth. Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth stongly rebounded in 2013 - quarter 1 (+0.3%), 2 (+0.7%) and 3 (+0.8%), to surpass all expectations as all three main sectors, services, manufacturing and construction contributed to this strong upturn. The Bank of England has, therefore, upgraded growth forecasts in the August and November quarterly Inflation Reports for 2013 from 1.2% to 1.6% and for 2014 from 1.7% to 2.8%, (2015 unchanged at 2.3%).

The November Report stated that: -

> *In the United Kingdom, recovery has finally taken hold. The economy is growing robustly as lifting uncertainty and thawing credit conditions start to unlock pent-up demand. But significant headwinds — both at home and abroad — remain, and there is a long way to go before the aftermath of the financial crisis has cleared and economic conditions normalise. That underpins the MPC's intention to maintain the exceptionally stimulative stance of monetary policy until there has been a substantial reduction in the degree of economic slack. The pace at which that slack is eroded, and the durability of the recovery, will depend on the extent to which productivity picks up alongside demand. Productivity growth has risen in recent quarters, although unemployment has fallen by slightly more than expected on the back of strong output growth.*

So very encouraging - yes, but, still a long way to go! However, growth is expected to be strong for the immediate future. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth.

Forward guidance. The Bank of England issued forward guidance in August which said that the Bank will not start to consider raising interest rates until the jobless rate (Labour Force Survey / ILO i.e. not the claimant count measure) has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years in August, but revised to possibly quarter 4 2014 in November. The UK unemployment rate currently stands at 2.5 million i.e. 7.6 % on the LFS / ILO measure. The Bank's guidance is subject to three provisos, mainly around inflation; breaching any of them would sever the link between interest rates and unemployment levels. This actually makes forecasting Bank Rate much more complex given the lack of available reliable forecasts by economists over a three year plus horizon. The recession since 2007 was notable for how unemployment did NOT rise to the levels that would normally be expected in a major recession and the August Inflation Report noted that productivity had sunk to 2005 levels. There has, therefore, been a significant level of retention of labour, which will mean that a significant amount of GDP growth can be accommodated without a major reduction in unemployment.

Credit conditions. While Bank Rate has remained unchanged at 0.5% and quantitative easing has remained unchanged at £375bn in 2013, the Funding for Lending Scheme (FLS), aimed at encouraging banks to expand lending to small and medium size enterprises, has been extended. The FLS certainly seems to be having a positive effect in terms of encouraging house purchases (though levels are still far below the pre-crisis level), FLS is also due to be bolstered by the second phase of Help to Buy aimed at supporting the purchase of second hand properties, which is now due to start in earnest in January 2014. While there have been concerns that these schemes are creating a bubble in the housing market, the house price increases outside of London and the south-east have been minimal. However, bank lending to small and medium enterprises continues to remain weak and inhibited by banks still repairing their balance sheets and anticipating tightening of regulatory requirements.

Inflation. Inflation has fallen from a peak of 3.1% in June 2013 to 2.2% in October. It is expected to fall back to reach the 2% target level within the MPC's two year time horizon.

AAA rating. The UK has lost its AAA rating from Fitch and Moody's but that caused little market reaction.

Capita Asset Services forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds.

There could well be volatility in gilt yields over the next year as financial markets await the long expected start of tapering of asset purchases by the Fed. The timing and degree of tapering could have a significant effect on both Treasury and gilt yields. Equally, at the time of writing, the political deadlock and infighting between Democrats and Republicans over the budget, and the raising of the debt limit, has only been kicked down the road, rather than resolved. Resolving these issues could have a significant effect on gilt yields during 2014.

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 of bond issuance in other major western countries. Increasing investor confidence in economic recovery is also likely to compound this effect as a continuation of recovery will further encourage investors to switch back from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly weighted. However, only time will tell just how long this period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis, or a break-up of the EZ, but rather that there will be a managed, albeit painful and tortuous, resolution of the debt crisis where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be tepid for the next couple of years and some EZ countries experiencing low or negative growth, will, over that time period, see a significant increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the large countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Downside risks currently include:

- UK strong economic growth is currently very dependent on consumer spending and recovery in the housing market. This is unlikely to endure much beyond 2014 as most consumers are maxed out on borrowing and wage inflation is less than CPI inflation, so disposable income is being eroded.
- A weak rebalancing of UK growth to exporting and business investment causing a major weakening of overall economic growth beyond 2014
- Weak growth or recession in the UK's main trading partners - the EU and US, depressing economic recovery in the UK.
- Prolonged political disagreement over the US Federal Budget and raising of the debt ceiling
- A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.
- A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis
- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- The Italian political situation is frail and unstable; this will cause major difficulties in implementing austerity measures and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.
- Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts, especially if it looks likely that one, or more countries, will need to leave the Eurozone.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds

The potential for upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- A sharp upturn in investor confidence that sustainable robust world economic growth is firmly expected, causing a surge in the flow of funds out of bonds into equities.
- A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone.
- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
- In the longer term – an earlier than currently expected reversal of QE in the UK; this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.

APPENDIX 5 Specified and Non-Specified Investments

Specified Investments:

The idea of specified investments is to identify investments offering high security and high liquidity. All these investments should be in sterling and with a maturity of less than one year.

Schedule A

	Security / Minimum Credit Rating	Maximum Maturity Period
Local authorities	N/A	1 year
DMADF – UK Government	N/A	1 year
Money market funds	AAA	Liquid
Term deposits with banks and building societies	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
Certificates of deposits (CDs) issued by credit rated deposit takers (banks and building societies)	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
UK Government Gilts	UK sovereign rating	364days
UK Government Treasury Bills	UK sovereign rating	364days

Non-Specified Investments

These are any investments which do not meet the specified investment criteria. The aim is to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies which do not have a “high” credit rating. As far as this Council is concerned the risks are in relation to the value of the investments, which may rise or fall, rather than deficient credit rating. There is no intention to invest in Non- Specified Investments without taking specialist advice first.

Schedule B

Investment	Security / Minimum credit rating	(A) Why use it? (B) Associated risks
UK Government Gilts with maturities in excess of 1 year Custodial arrangement required prior to purchase	Government backed	(A) (i) Excellent credit quality. (ii) Very liquid. (iii) if held to maturity, known yield (rate of return) per annum – aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk. (B) (i) ‘Market or interest rate risk’: Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.

APPENDIX 6 Approved Countries for Investments

Countries that meet our criteria 1, 2, 3:-

1. AAA rated

   Australia
   Canada
   Denmark
   Finland
   Germany
   Luxembourg
   Norway
   Singapore
   Sweden
   Switzerland

2. AA+

   Hong Kong
   Netherlands
   U.K.
   U.S.A.

3. AA
   Abu Dhabi (UAE)
   France
   Qatar

Some of the countries that do not meet our criteria include:-

Belgium
Japan
Kuwait
Saudi Arabia
Spain
Italy

APPENDIX 7 Treasury Management Policy Statement

The Council defines its treasury management activities as: “The management of the 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”.

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

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

APPENDIX 8 Purpose and requirements of the code

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

APPENDIX 9 Treasury Management Scheme of Delegation

(i) Full Council

1.Approval of the Treasury Management Strategy - prior to the new financial year
2.Approval of the Investment Strategy - prior to the new financial year
3.Approval of the MRP Policy - prior to the start of the new financial year
4.Approval of any amendments required to the Strategy during the year
5.Receipt of a mid year report on the Treasury Management Strategy, to include consideration of any recommendations of the Cabinet or Audit Committee arising from any concerns since the original approval.

(ii) Cabinet

1. Developing and determining the Treasury Management strategy, Investment Strategy and MRP policy and recommending them to full Council - prior to the start of the new financial year
2. Receipt of a mid year report on the Treasury Management Strategy and any concerns since the original approval and making recommendations to Council as appropriate.
2. Receiving, and reviewing reports on treasury management policies, practices, activities, and performance reports (based on quarterly reporting).
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(iii) Audit Committee

1. Scrutinising the Council's Treasury Management Strategy, Investment Strategy and MRP policy, Treasury Management Policy Statement and Treasury Management Practices and making recommendations to Cabinet and Council as appropriate.
2. Receiving and reviewing monitoring reports (based on quarterly reporting) and making recommendations as appropriate.

APPENDIX 10 The Treasury Management Role of the Section 151 Officer

Head of Finance (S151 Officer)

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.