Agenda Item No:

Report to: Cabinet

Date of Meeting: 16 February 2015

Report Title: Treasury Management and Annual Investment Strategy 2015/16

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 £14.2 million of debt, and investments which can fluctuate between £15million and £25million at any one time in 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 (2015/16) prior to the start of the new financial year.

Recommendation(s)

1. **The Cabinet recommend that the Council approve approve the Treasury Management Strategy, Minimum Revenue Provision (MRP) Policy and Annual Investment Strategy (2015/16)**
2. **The Cabinet recommend to Council that the current year's Strategy remains unaltered (Appendix 10).**

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 7.

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 at its meeting on the 21 January 2015, as delegated by Council, scrutinised the Mid Year Treasury Management report and this Treasury

Management and Annual Investment Strategy for 2015/16. The Committee accepted the proposed strategies and resolved unanimously that there were no areas that they wished to draw to the attention of Cabinet.

Investment Performance 2014-15

8. The performance for the first 9 months of 2014/15 provided an average return of 0.65% (excludes Local Authority Mortgage (LAM) scheme).This compares to 0.91% for the same period last year. The government's Funding for Lending Scheme has resulted in the interest rates on offer to local authorities diminish significantly over the last 18 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 December are between 0.6% and 0.95%.

9. The total interest earned for the first 9 months is £125,000 (excluding Local Authority Mortgage Scheme). This compares to £166,000 for the same period last year.

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

11. The Cabinet and full Council consider a Mid Year report on Treasury Management based on the performance and activities and issues that may have arisen since setting the strategies before the start of the financial year. The mid year report has been included within this report (see Appendix 10). The Cabinet is asked to consider the Mid Year Review and to make recommendations to Council as appropriate.

Treasury Management Strategy for 2015/16

12. 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.

13. 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.

14. The suggested strategy for 2015/16 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 called Sector).

15. 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. The third Local Authority Mortgage Scheme did not proceed partly due to the introduction of the Government's help to buy scheme.

ii. The loan value in regards to Amicus Horizon and the Coastal Space Regeneration project was reduced and requested later than originally planned which in turn reduced the Minimum Revenue Provision (MRP) required

iii. That investment returns are expected to remain fairly consistent rather than continuing to reduce.

Balanced Budget

16. 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 2015/16 TO 2017/18

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

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

19. 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'.

20. 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.

21. 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.

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

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

PRUDENTIAL AND TREASURY INDICATORS FOR 2014/15 TO 2017/18

24. 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

25. The Council's debt position at 31 December 2014 comprised:

Table 1 **Debt**	31 March 2014 Principal	Rate	Maturity	30 December 2014 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%
PWLB Loan 4	£2.0m	0.55% (Variable Rate)	2019	£2.0m	0.56% (Variable Rate*)
PWLB Loan 5	£0m		2044	£0.9m	3.78%
PWLB Loan 6	£0m		2044	£1.8m	3.78%
Total Debt	£11.5m	3.54%		£14.2m	3.59%

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

BORROWING REQUIREMENT

26. 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

27. 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).

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

    - 2014/15 0.50%
    - 2015/16 1.00%
    - 2016/17 1.50%

29. Strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), were followed by 0.7% in Q1, 0.9% in Q2 and 0.7% in Q3 2014 (annual rate 3.0% in Q3). It hopeful that growth will continue into 2015 as forward surveys for the services and construction sectors are encouraging and business investment is also more modestly recovering.

30. Also encouraging has been the sharp fall in inflation (CPI) during 2014 after being consistently above the MPC's 2% target between December 2009 and December 2013. CPI Inflation fell to 0.5% in December 2014, a five year low, whilst RPI was 1.6%. Forward indications are that inflation may now fall even further in the first half of 2015 and then to increase again as the fuel decreases fall out of the calculation, but inflation is still expected to remain low - near to the 2% target level over the MPC's two year ahead time horizon

31. 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.

32. The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. During November, the ECB stated that if this latest programme failed to stimulate growth, then it would soon embark on full quantitative easing (purchase of sovereign debt). Current fears over Greece have seen the value of the Euro fall in the currency exchange markets.

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

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2015/16 and for a period beyond;
- The borrowing interest rates have risen so it is necessary consider the timing of any borrowing to ensure the best deals are obtained;
- 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.

34. A detailed view of the current economic background by Capita Asset services is contained within the Treasury Management Mid Year Report.

BORROWING STRATEGY

The Council again registered for the PWLB 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 2014	0.50	2.50	3.90	3.90
Mar 2015	0.50	2.70	4.00	4.00
Jun 2015	0.75	2.70	4.10	4.10
Sep 2015	0.75	2.80	4.30	4.30
Dec 2015	1.00	2.90	4.40	4.40
Mar 2016	1.00	3.00	4.50	4.50
Jun 2016	1.25	3.10	4.60	4.60
Sep 2016	1.25	3.20	4.70	4.70
Dec 2016	1.50	3.30	4.70	4.70
Mar 2017	1.50	3.40	4.80	4.80
Jun 2017	1.75	3.50	4.80	4.80
Sep 2017	2.00	3.50	4.90	4.90
Dec 2017	2.25	3.50	4.90	4.90
Mar 2018	2.50	3.50	5.00	5.00

35. 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. Preference will be given to PWLB borrowing by maturity loans

e. Rates are expected to gradually increase during next year. The Council need to be alert to opportunities particularly at the start of the year.

36. 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	2013/14	2014/15	2015/16	2016/17
	Actuals	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000
External debt (gross) at 1st April	11,500	11,500	14,300	16,225
Expected change in debt	0	2,800	1,925	0
Other Long term liabilities at 1st April	0	0	0	0
Actual Gross Debt at 31st March	11,500	14,300	16,225	16,225
CFR	16,372	18,676	20,087	19,536
Under/(Over) borrowed	4,872	4,376	3,862	3,311

37. The additional new borrowing in 2014/15 results from delays to the Coastal Space project in partnership with Amicus Horizon (previously scheduled for 2013/14). New loans 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 £1.8m loan to Amicus Horizon (Amicus Horizon meet the interest and principal repayments).

38. The general aim of this treasury management strategy is to minimise 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.

39. 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.

40. However, short term savings by avoiding new long term external borrowing in 2015/16 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.

41. 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 2015/16 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.

42. 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.

43. Against this background caution will be adopted with the 2015/16 treasury operations.

Policy on borrowing in advance of need

44. 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.

45. 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

46. 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.

47. 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.

48. 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)

49. 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.

50. 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 2015/16 is estimated at £514,000 (the statutory charge to revenue that remains within the accounts).

ANNUAL INVESTMENT STRATEGY

Investment Policy

51. 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.

52. 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.

53. 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.

54. Investment instruments identified for use in the financial year are listed in Appendix 4 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

55. 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.

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 5. 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.

64. The Council transferred to Lloyds Bank on 1st December 2014, whilst the counterparty limit is set at £5 million for most institutions, the level of investments that is held with Lloyds Bank is £5 million plus up to £500,000 short term. In addition there is £2 million invested in respect of LAMS – a total exposure of up to £7.5m at any one time.

Investment Strategy

The table below provides a snapshot of where the investments are placed (as at 31 December 2014). The level varies daily.

Counter Party	Rate/ Return	Start Date	End Date	Principal	Term
Barclays Bank PLC	0.65%	25/04/2012		£0.001m	On Call
CBA	0.20%	22/12/2014	05/01/2015	£2.85m	
Nordea Bank	0.60%	01/10/2014	01/04/2015	£5m	
Lloyds 1	4.45%	05/01/2012	10/01/2017	£1.0m	Fixed
Lloyds 2	1.97%	26/03/2013	26/03/2018	£1.0m	Fixed
Lloyds 1 year fixed	0.95%	11/04/2014	10/04/2015	£5.0m	Fixed
Nat west	0.60%	21/08/2013		£5.0m	On call 90 day notice
Standard Chartered	0.65%	01/10/2014	01/04/2015	£5.0m	
				£ 24.85m	

The year end balance is expected to be in the region of £19m.

65. 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.

66. For 2014/15 the Council's revised budget estimates an investment interest return of 0.75%, and in 2015/16 the return is budgeted at 0.70%.

67. 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

68. 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

69. 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.

70. The Council was given notice by the Co-op Bank that they will not be tendering for any new contracts. Hastings entered into a joint procurement with Eastbourne Borough Council, Lewes District Council, Rother District Council and Wealden District Council and Lloyds bank was appointed. Hastings was one of the first authorities to switch and went live with Lloyds on 1st December 2014.

Scheme of delegation

71. Please see Appendix 8.

Role of the Section 151 Officer

72. Please see Appendix 9.

RISK MANAGEMENT

73. 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.

74. 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.

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 £19m by the end of March 2015. 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. Specified and non specified investments

5. Approved countries for investments
6. Treasury Management Policy Statement
7. Purpose and requirements of the code
8. Treasury management scheme of delegation
9. The treasury management role of the section 151 officer
10.Treasury Management - Mid year Review

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

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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 2015/16

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09 , and will assess the MRP for 2015/16 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 2015/16 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 2015 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. It should also be noted that the Council will not make any MRP in regards of the loans to Amicus Horizon in respect of the Coastal Space scheme. Amicus Horizon will meet the costs of the loan (Principal and Interest).

APPENDIX 2 Interest Rate Forecasts

The data below shows Sectors forecast

Capita Asset Services Interest rate forecast - 2014-2018

Capita Asset Services Interest Rate View	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank Rate View	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.25%	2.50%
3 Month LIBID	0.50%	0.60%	0.80%	0.90%	1.10%	1.30%	1.40%	1.60%	1.90%	2.10%	2.10%	2.30%	2.40%	2.60%
6 Month LIBID	0.70%	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.80%
12 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.70%	1.80%	2.10%	2.20%	2.30%	2.40%	2.60%	2.80%	3.00%
5yr PWLB Rate	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%	3.50%	3.50%
10yr PWLB Rate	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.20%	4.30%	4.30%
25yr PWLB Rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
50yr PWLB Rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
Bank Rate														
Capita Asset Ser	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.25%	2.25%	2.50%
Capital Economic	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	-	-	-	-	-
5yr PWLB Rate														
Capita Asset Ser	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
Capital Economic	2.30%	2.60%	2.80%	3.00%	3.20%	3.40%	3.50%	3.60%	3.70%	-	-	-	-	-
10yr PWLB Rate														
Capita Asset Ser	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.40%	4.40%	4.40%
Capital Economic	3.05%	3.25%	3.45%	3.60%	3.80%	3.85%	3.90%	3.95%	4.05%	-	-	-	-	-
25yr PWLB Rate														
Capita Asset Ser	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	5.00%	5.00%	5.00%
Capital Economic	3.70%	3.95%	4.05%	4.15%	4.25%	4.35%	4.45%	4.55%	4.60%	-	-	-	-	-
50yr PWLB Rate														
Capita Asset Ser	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	5.00%	5.00%	5.00%
Capital Economic	3.80%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	-	-	-	-	-

Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

APPENDIX 3 Prudential Indicators

PRUDENTIAL INDICATOR	2013/14	2014/15	2015/16	2016/17	2017/18
(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	£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
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 variable 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	£5,620	£5,620	£6,000	£6,000	£6,000

Maturity structure of fixed rate borrowing during 2015/16	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 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 5 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
   U.S.A.
   Netherlands

2. AA+

   Hong Kong
   U.K.

3. AA
   Abu Dhabi (UAE)
   France
   Belgium
   Saudi Arabia

Examples of countries that do not meet our criteria :-

Japan
Kuwait
Spain
Italy
Qatar

APPENDIX 6 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 7 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 8 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).
.

(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 9   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.

Agenda Item No:

Report to: Cabinet

Date of Meeting: 16 February 2015

Report Title: **Treasury Management - Mid Year Report 2014-15**

Report By: Peter Grace
Head of Finance

Purpose of Report

This report advises cabinet of the Treasury Management activities and performance during the current year. It provides the opportunity to review the Treasury Management Strategy and make appropriate recommendations to Council to take account of any issues or concerns that have arisen since approving it in February 2014.

Recommendation(s)

1. **Cabinet recommend to Council that the current year's Strategy remains unaltered.**
2. **To accept the report and note that the investments made are in compliance with the investment strategy and the latest advice provided from the Council's Treasury Management advisers.**

Reasons for Recommendations

The Code of Practice on Treasury Management requires, as a minimum, a mid-year review of Treasury Management Strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved (February 2014). It is a requirement of the Code of Practice that the Mid year review is considered by full Council.

Introduction

1. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties.

2. The other main part of the treasury management service is the funding of the Council's capital plans. Whilst parts of the Capital programme are financed by grants, contributions or capital receipts, the unfinanced elements will determine the borrowing needs of the Council - essentially the longer term cash flow planning to ensure the Council can fund its capital spending. The management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

3. Accordingly treasury management is defined 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."

4. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) has been adopted by this Council and this Council fully complies with its requirements.

5. The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- 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 (as a minimum) and an Annual Report covering activities during the previous year.
- 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.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Audit Committee.

6. The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the Mid Year review of treasury management activities, for the financial year 2014/15.

7. This mid-year report covers

   a) An economic update for the first nine months of 2014/15;
   b) The Council's treasury position
   c) A review of the Council's borrowing strategy in 2014/15
   d) A review of the Council's investment strategy in 2014/15
   e) A review of compliance with treasury management prudential indicator limits for 2014/15

8. The Audit Committee at its meeting on the 21 January 2015, as delegated by Council, scrutinised the Mid Year Treasury Management report. The Committee accepted the report and resolved unanimously that there were no areas that they wished to draw to the attention of Cabinet or Council.

Economic Update

Economic performance to date

9. Strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), were followed by 0.7% in Q1, 0.9% in Q2 and 0.7% in Q3 2014 (annual rate 3.0% in Q3). It hopeful that growth will continue into 2015 as forward surveys for the services and construction sectors are encouraging and business investment is also more modestly recovering.

10. This overall growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC**)** last August, before it said it would consider any increases in Bank Rate.

11. It is forecasted that growth will peak in 2014 and then to ease off a little in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to feed through into a return to increases in real pay rates at some point during the next three years.

12. Also encouraging has been the sharp fall in inflation (CPI) during 2014 after being consistently above the MPC's 2% target between December 2009 and December 2013. CPI Inflation fell to 1.2% in September 2014, a five year low, whilst RPI was 2.3%. Forward indications are that inflation is likely to fall further in the first half of 2015 to possibly near to or below 1% and then to remain near to the 2% target level over the MPC's two year ahead time horizon. Overall, markets are expecting that the MPC will be cautious in raising the Bank Rate as it will want to protect heavily indebted consumers from too early an increase in the Bank Rate at a time when inflationary pressures are also weak. A first increase in the Bank Rate is therefore currently forecast for Q2 2015 and the Bank has said that increases after that will be at a slow pace and to lower levels than prevailed before 2008.

13. The return to growth in 2013 and 2014 helped to lower forecasts for the increase in Government debt in the 2013 Autumn Statement, and the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed in the first seven months of 2014/15 and the autumn statement in December 2014 pushed back the achievement of a budget surplus until 2019-20.

14. **The Eurozone (EZ).** The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. During November, the ECB stated that if this latest programme failed to stimulate growth, then it would soon embark on full quantitative easing (purchase of sovereign debt). Current fears over Greece have seen the value of the Euro fall in the currency exchange markets.

Outlook for the next six months

15. 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, or the safe haven of bonds. Comments by the ECB in respect of the potential start of quantitative easing in early 2015 have also sharply depressed gilt yields during the closing weeks of 2014.

16. The overall 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. Over time, an increase in investor confidence in world economic recovery is also likely to compound this effect as recovery will further encourage investors to switch from bonds to equities.

17. 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 economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

Downside risks to UK gilt yields and PWLB rates include:

- Commencement of substantial quantitative easing by the ECB in early 2015.
- Weak growth or recession in the UK's main trading partner - the EU, inhibiting economic recovery in the UK.
- UK economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014.
- 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.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.

18. Upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
- Increased investor confidence that sustainable robust world economic growth is firmly expected, together with a reduction or end of QE operations in the US, causing a further 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.
- In the longer term - a 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.
- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt, consequent upon repeated failure to achieve fiscal correction targets and sustained recovery of economic growth, causing the ratio of total Government debt to GDP to rise to levels that provoke major concern.
- A surge in investor confidence that a return to robust world economic growth is imminent causing a flow of funds out of bonds into equities.

19. If the MPC does takes action to do more QE in order to reverse a rapid increase in market rates, especially in gilt yields and interest rates up to 10 years, such action could cause gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below.

Interest rate forecasts

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank Rate View	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.25%	2.50%
3 Month LIBID	0.50%	0.60%	0.80%	0.90%	1.10%	1.30%	1.40%	1.60%	1.90%	2.10%	2.10%	2.30%	2.40%	2.60%
6 Month LIBID	0.70%	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.80%
12 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.70%	1.80%	2.10%	2.20%	2.30%	2.40%	2.60%	2.80%	3.00%
5yr PWLB Rate	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%	3.50%	3.50%
10yr PWLB Rate	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.20%	4.30%	4.30%
25yr PWLB Rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
50yr PWLB Rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%

(The Capita Assets Services forecasts above are for PWLB certainty rates.)

The Council's Treasury Position – 31 December 2014

Borrowing

20. The Council's debt and investment position at the 31 December was as follows:

Table 1 **Debt**	31 March 2014 Principal	Rate	Maturity	30 December 2014 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%
PWLB Loan 4	£2.0m	0.55% (Variable Rate)	2019	£2.0m	0.56% (Variable Rate)
PWLB Loan 5	£0m		2044	£0.9m	3.78%
PWLB Loan 6	£0m		2044	£1.8m	3.78%
Total Debt	£11.5m	3.54%		£14.2m	3.59%

21. At the 31 December 2014 the Council had debt amounting to £14.2m (all PWLB debt).

Investments in 2014-15

22. In terms of investments the Council had £24.85m invested as at 31 December 2014 with a variety of institutions (this level varies on a daily basis throughout the year).

23. The table below provides a snapshot of where the investments are placed (as at 31 December 2014)

Counter Party	Rate/ Return	Start Date	End Date	Principal	Term
Barclays Bank PLC	0.65%	25/04/2012		£0.001m	On Call
CBA	0.20%	22/12/2014	05/01/2015	£2.85m	
Nordea Bank	0.60%	01/10/2014	01/04/2015	£5m	
Lloyds 1	4.45%	05/01/2012	10/01/2017	£1.0m	Fixed
Lloyds 2	1.97%	26/03/2013	26/03/2018	£1.0m	Fixed
Lloyds 1 year fixed	0.95%	11/04/2014	10/04/2015	£5.0m	Fixed
Nat west	0.60%	21/08/2013		£5.0m	On call 90 day notice
Standard Chartered	0.65%	01/10/2014	01/04/2015	£5.0m	
				£ 24.85m	

INVESTOR IN PEOPLE

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24. The performance for the first 9 months of 2014/15 provided an average return of 0.65% (excluding Local Authority Mortgage Scheme (LAMS). This compares to 0.91% for the same period last year

25. The total interest receivable for the first 9 months is £125,000 (excluding Local Authority Mortgage Scheme). This compares to £166,000 for the same period last year.

Borrowing Strategy

26. The Council has £14.2m of PWLB debt, and could potentially borrow up to a level of £17.0m. This figure takes account of capital spending of some £4.5m in 2014/15 of which some £2.8m has been funded by new borrowing to date.

27. A new capital scheme involving the construction of a new industrial unit has been approved by the council in the year. This has an estimated capital cost of £700,000 and is likely to be financed through borrowing in 2015/16.

28. The coastal space regeneration project (£3.62m) achieved 38 units of the 51 projected but at a reduced cost of £2.7m. This is the sum that has been borrowed rather than the £3.62m originally predicated.

29. Whilst the borrowing rates are attractive on a historical basis the difference between the return on investment and the cost of borrowing is significant – the revenue cost falling on the Council taxpayer. Rates have reduced when compared to last year so careful attention is being made when placing funds for longer periods of time.

30. The Council also keeps under review the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. However, the cost of the early repayment premiums that would be incurred and the increase in risk exposure to significantly higher interest rates for new borrowing, continue to make this option unattractive. No debt rescheduling is being contemplated at present

Investment Strategy

31. Priority is given to security and liquidity of investments in order to reduce counterparty risk to the maximum possible extent.

32. The Council has a limit of £5m with any one institution (rated A or above, supported by Government, and given a blue (12month) rating by Sector). This represents a level of up to 25% of the investment portfolio with any one institution or group at any one time. It is also necessary, at times, to invest sums of this size in order to attract the larger institutions which have the higher credit ratings.

33. The continuing Eurozone problems have led to a number of downgrades to banks' credit ratings, making it increasingly difficult to spread investments across a number of institutions. The Head of Finance has the authority to amend the limits.

    Table 3 below compares the Estimated Interest Payable and Received and associated fees for the year 2014/15.

Table 3	2014 -15 Budget year £000's	2014 -15 Estimated Outturn £000's
Gross Interest Payable	576	450
Gross Interest Received	(282)	(218)
Fees	13	13
Investment Property (Income) / Expense (net)	(73)	21
Other (e.g. PWLB Discount)	(53)	(53)
Net Cost	181	213

34. From the table above whilst the overall budget position is generally in line with forecasts, both the level of interest payable and receivable are lower than forecast. This is due to the difference in timing and loan value in respect of the Amicus Horizon in relating to the Coastal Space Regeneration project.

35. The net interest on the deposits in respect of the LAM scheme for the year will amount to some £27,700 and will be transferred into the mortgage reserve in order to meet potential defaults (none at present).

Compliance with Treasury Limits

36. During the financial year to date there have been a few occasions where it has not been possible to find institutions to take the Council's money given the strict criteria in place. In these circumstances the Council will place money in its existing call accounts and this can thus result in the investments exceeding general limits. Where such an occasion looks likely to arise the approval of the Head of Finance is required in compliance with the Council's Treasury Management Practices.

37. The Prudential Indicators have been complied with - reproduced in Appendix 1 for reference.

38. There was an under spend in the Capital programme in 2013/14 with some expenditure being carried forward into 2014/15. The Council's overall borrowing requirement has not however increased and therefore there are no negative implications for the Council's revenue budget. The revisions will be taken account of in the Council's revised budget for 2014/15 and in future year estimates.

Financial Implications

39. The Council's 2014/15 budget estimated a 1% return on investments. Based on current market conditions this will be increasingly difficult to achieve given the lower interest rates currently available. However savings from the timing of new borrowing should help to ensure overall budget projections are achieved.

Risk Management

40. The Council spreads its risk on investments by limiting the amount of monies with any one institution or group and limiting the timeframe of the exposure. In determining the level of the investment and period the Council considers formal credit ratings (Fitch) along with its own advisers (Capita Asset Services) ratings advice.

41. The security of the principal sum remains of paramount importance to the Council.

Wards Affected

Ashdown, Baird, Braybrooke, Castle, Central St. Leonards, Conquest, Gensing, Hollington, Maze Hill, Old Hastings, Ore, Silverhill, St. Helens, Tressell, West St. Leonards, Wishing Tree

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Area(s) Affected

Central Hastings, East Hastings, North St. Leonards, South St. Leonards

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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	No
Local People's Views	No

Officer to Contact

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APPENDIX 1

PRUDENTIAL INDICATOR	2013/14	2014/15	2015/16	2016/17	2017/18
(**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	£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
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 variable rate borrowing / investments OR:-	100 %	100 %	100 %	100 %	100 %
Upper limit for total principal sums invested for over 364 days – LAMS Scheme and Coastal Space	£5,620	£5,620	£6,000	£6,000	£6,000

Maturity structure of fixed rate borrowing during 2013/14	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%