Report to	Cabinet	**Item**
	13 February 2013	10
Report of	Chief Finance Officer	
Subject	Treasury Management Strategy 2013-14	

Purpose

This report outlines the Council's prudential indicators for 2013/14 through to 2015/16 and sets out the expected treasury operations for this period. It fulfils three key reports required by the Local Government Act 2003:

a) The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities;
b) The Minimum Revenue Provision (MRP) Policy, as required by Regulation under the Local Government and Public Involvement in Health Act 2007 (Appendix A); and
c) The treasury strategy in accordance with the CIPFA Code of Practice on Treasury Management.

The investment strategy is in accordance with the Department of Communities and Local Government investment guidance

Recommendation

The cabinet is asked to consider each of the key elements of these reports, and recommend these to council for approval:

a) The Capital Prudential Indicators and Limits for 2013/14 to 2015/16 contained within Section 5 of this report;

b) The Borrowing Strategy 2013/14 to 2015/16 (Section 7);

c) The Treasury Prudential Indicators (Section 8), including the Authorised Limit (contained in paragraph 8.2);

d) The Minimum Revenue Provision (MRP) policy statement contained within Section 9.; and

e) The Investment Strategy 2013/14 (Section 10) and the detailed criteria included in Appendix 3.

Corporate and service priorities

The report helps to meet the corporate priority "value for money services"

Financial implications

The report has no direct financial consequences however it does set the guidelines for how the Council manages its borrowing and investment resources

Ward/s: all wards

Cabinet member: Councillor Waters – Deputy leader and resources

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Background documents

None

Report

1. Introduction

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

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

1.3. CIPFA defines treasury management as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. Reporting Requirements

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

A treasury management strategy statement, including prudential and treasury indicators (this report) **-** The first, and most important report covers:

a) capital plans, including prudential indicators;
b) the treasury management strategy, including treasury indicators; and
c) the Minimum Revenue Provision (MRP) policy, describing how residual capital expenditure is charged to revenue over time;
d) the investment strategy.

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

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

3. Treasury Management Strategy Statement for 2013/14

3.1. The strategy statement for 2013/14 covers the following areas:

a) current treasury management position;
b) capital plans and prudential indicators;
c) prospects for interest rates;
d) borrowing strategy, including the policy on borrowing in advance of need and debt rescheduling;
e) treasury indicators: limits to borrowing activity and affordability, designed to limit the treasury risk to the Council;
f) minimum revenue provision (MRP) strategy.
g) annual investment strategy;
h) creditworthiness policy; and
i) policy on use of external service providers.

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

4. Current treasury management position

4.1. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet service activity, including capital expenditure plans. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities.

4.2. The Council's treasury portfolio position at 31 March 2012, with forward projections, is summarised below. The table shows the actual external debt (treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£000	2011/12 Actual	2012/13 Forecast	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
External debt					
Debt at 1 April	93,270	242,100	224,477	224,477	224,277
Expected change in debt	148,898	(17,623)	-	-	4,302
Other long-term liabilities (OLTL)	1,569	1,501	1,429.	1,353	1,273
Expected change in OLTL	(68)	(72)	(76)	(80)	(84)
Actual debt at 31 March	**242,601**	**225,906**	**225,830**	**225,750**	**229,968**
Capital Financing Requirement (CFR)	**237,185**	**235,438**	**234,595**	**233,785**	**237,310**
Under / (over) borrowing	**(6,416)**	**9,532**	**8,765**	**8,035**	**7,342**
Total Investments at 31 March					
Investments	55,130	45,000	45,000	45,000	45,000
Investments change	3,553	(10,130)	-	-	-
Net Debt	**187,471**	**180,906**	**180,830**	**180,870**	**184,968**

4.3. Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

4.4. The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

5. Capital plans and prudential indicators

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

5.2. **Capital expenditure:** This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle - the table below includes the HRA self financing borrowing of £148,898m approved during 2011/12.

Capital Expenditure £000	2011/12 Actual	2012/13 Forecast	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Non-HRA	5,896	4,195	8,767	3,453	2,140
HRA	161,434	30,671	33,266	33,855	41,174
Total	**166,431**	**34,866**	**42,033**	**37,308**	**43,314**

The financing need in the table above excludes other long term liabilities such as leasing arrangements which already include borrowing instruments.

5.3. The table below shows how capital expenditure plans are being financed by capital or revenue resources. Any shortfall of resources results in a borrowing need.

Capital Funding £000	2011/12 Actual	2012/13 Forecast	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Financed by:					
Capital receipts	3,293	6,561	5,938	3,804	2,528
Capital grants	2,171	2,208	3,502	682	644
Reserves	6,234	24,686	17,574	13,690	13,626
Revenue	7,993	1,469	15,019	19,132	22,214
Total resources	**19,691**	**34,925**	**42,033**	**37,308**	**39,012**
Net borrowing need for the year	**146,740**	**(59)**	**-**	**-**	**4,302**

5.4. **The Councils borrowing need (the Capital Financing Requirement)**
The second prudential indicator is the Council's Capital Financing Requirement

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

5.5. The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

5.6. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £1.43m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

Capital Financing Requirement £000	**2011/12 Actual**	**2012/13 Forecast**	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**
CFR Non-HRA	23,639	21,081	20,238	19,428	18,651
CFR HRA	213,546	214,357	214,357	214,357	218,659
Total CFR	**237,185**	**235,438**	**234,595**	**233,785**	**237,310**
Movement in CFR	146,740	(1,748)	(843)	(810)	3,525
Movement in CFR is represented by					
Net financing need for the year (above)	146,740	(59)	-	-	4,302
Less MRP/VRP and other financing movements		(1,689)	(843)	(810)	(777)
Movement in CFR	146,740	(1,748)	(843)	(810)	3,525

Note: the MRP/VRP includes finance principle payments. VRP is Voluntary Revenue Provision

6. Prospects for interest rates

6.1. The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2012	0.50	1.50	3.70	3.90
Mar 2013	0.50	1.50	3.70	3.90
June 2013	0.50	1.50	3.70	3.90
Sept 2013	0.50	1.60	3.80	4.00
Dec 2013	0.50	1.70	3.80	4.00
Mar 2014	0.50	1.80	3.90	4.10
June 2014	0.50	1.90	4.00	4.20
Sept 2014	0.50	2.00	4.10	4.30
Dec 2014	0.75	2.10	4.20	4.40
Mar 2015	1.00	2.30	4.30	4.50

Further detailed interest rate forecasts are given in Appendix 1.

6.2. The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the economy did come out of recession in the third quarter of 2012. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to the repayment of personal debt, general malaise about the economy and employment fears.

6.3. 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 are likely to continue to hinder UK growth. The US, the main world economy, faces similar debt problems to the UK, but is unlikely to address these before the outcome of the Presidential elections in November 2012. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth from the original expectations and is likely to see the UK deficit reduction plans slip.

6.4. A more detailed assessment of the economic context is given in Appendix 2.

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

a) 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;
b) Investment returns are likely to remain relatively low during 2013/14 and beyond;

c) Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully;

d) 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.

7. Borrowing Strategy

7.1. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

7.2. Against this background and the risks within the economic forecast, caution will be adopted with the 2013/14 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

a) *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

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

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

7.3. **Policy on borrowing in advance of need:** The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

7.4. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

7.5. **Debt rescheduling:** As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

7.6. The reasons for any rescheduling to take place may include:

a) the generation of cash savings and / or discounted cash flow savings;

b) helping to fulfil the treasury strategy;

c) enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

7.7. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

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

8. Treasury indicators: limits on borrowing activity and affordability

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

Operational boundary £000	**2011/12 Actual**	**2012/13 Forecast**	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**
Debt	242,100	224,477	224,477	224,477	224,477
Other Long term Liabilities	1,501	1,429.	1,353	1,273	1,189
Total	**242,601**	**225,906**	**225,830**	**225,750**	**229,968**

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

a) This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

b) The Council is asked to approve the following authorised limit:

Authorised Limit £000	2011/12 Actual	2012/13 Forecast	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	262,100	264,477	264,477	264,477	264,477
Other Long term Liabilities	1,501	1,429.	1,353	1,273	1,189
Total	**262,601**	**265,906**	**265,830**	**265,750**	**265,666**

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

HRA debt limit £000	2011/12 Actual	2012/13 Forecast	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Total	213,546	214,357	214,357	214,357	218,659

8.4. There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

a) **Upper limits on variable interest rate exposure:** This identifies a maximum limit for variable interest rates based upon the debt position net of investments;

b) **Upper limits on fixed interest rate exposure:** This is similar to the previous indicator and covers a maximum limit on fixed interest rates; and

c) **Maturity structure of borrowing:** These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

£m	2013/14	2014/15	2015/16
Interest rate exposures			
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	20%	20%	20%
Limits on fixed interest rates: • *Debt only* • *Investments only*	100% 100%	100% 100%	100% 100%
Limits on variable interest rates • Debt only • Investments only	20% 20%	20% 20%	20% 20%
Maturity structure of fixed interest rate borrowing			
		Lower	**Upper**
Under 12 months		0%	10%
12 months to 2 years		0%	10%
2 years to 5 years		0%	30%
5 years to 10 years		0%	50%
10 years and above		0%	95%

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

- **Ratio of financing costs to net revenue stream:** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2011/12 Actual	2012/13 Forecast	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Non-HRA	3.15%	1.53%	0.92%	0.93%	0.93%
HRA	4.96%	13.09%	12.23%	11.59%	11.07%

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

- **Incremental impact of capital investment decisions on council tax:** This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the 2013/14 budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.
- **Incremental impact of capital investment decisions on the band D council tax:** The impact of capital expenditure on the Council Tax would be derived from the effect of Revenue Contributions to Capital on the Council Tax Requirement. Since the council does not budget for any significant revenue contributions, the impact on the Council Tax Requirement, and therefore Council tax, is nil.

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

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

  The impact of capital expenditure on council dwelling rents (if rent restructuring were being applied) would be derived from any effect of capital expenditure on the January 1999 dwelling values from which formula rents are calculated, moderated through the operation of caps and limits on annual rent increases/decreases. If rent restructuring were not being applied, the impact would be derived from the calculation of a rent requirement incorporating the effect of revenue contributions. Since the council applies rent restructuring, and does not adjust January 1999 values for the effect of capital expenditure, the impact on council dwelling rents is nil.

9. Minimum Revenue Provision (MRP) policy statement

9.1. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum

Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP).

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

a) For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be based on CFR. This provides for an approximate 4% reduction in the borrowing need (CFR) each year.

b) From 1 April 2008 for all unsupported borrowing, the MRP policy will be based on the estimated life of the assets. This option provides for a reduction in the borrowing need over approximately the asset's life.

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

d) Repayments included in annual finance leases are applied as MRP.

10. Annual investment strategy

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

Year end resources £000	**2011/12 Actual**	**2012/13 Forecast**	**2013/14 Estimate**	**2014/15 Estimate**	**2015/16 Estimate**
Fund balances / reserves	18,527	25,530	15,610	15,528	9,037
Capital receipts	12,596	10,596	4,658	3,143	2,755
Provisions	-	-	-	-	
Other	3,792	2,284	554	554	554
Working capital*	308,984	306,984	304,984	304,984	304,484
Expected investments	**55,130**	**45,000**	**45,000**	**45,000**	**45,000**

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

10.2. **Investment policy:** The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

10.3. In accordance with the above 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 these reflect in the eyes of each agengy. Using the Sector ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

10.4. Further, 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.

10.5. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

10.6. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

10.7. The intention of the strategy is to provide security of investment and minimisation of risk.

10.8. Investment instruments identified for use in the financial year are listed in Appendix 3 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices – schedules.

10.9. **Creditworthiness policy:** The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested.

10.10. The Chief Finance Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

10.11. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council’s minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council’s criteria, the other does not, the institution will fall outside the lending criteria. Credit rating information is supplied by Sector, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

10.12. The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) are:

a) Banks 1 - good credit quality **–** the Council will only use banks which:

   i.) are UK banks; and/or

   ii.) are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA

   iii.) and have, as a minimum, the following Fitch, Moody's and Standard Poors credit ratings (where rated):

b) Short term - F1, P1, A1

c) Long term – A, A2, A

d) Viability / financial strength – bbb+ (Fitch / Moody's only)

e) Support – *3*(Fitch only)

f) Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.

g) Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

h) Bank subsidiary and treasury operation - The Council will use these only where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

i) Building societies The Council will *use* all societies which:

   i.) meet the ratings for banks outlined above;

   ii.) Have assets in excess of £2bn; or,

   iii.) meet both criteria.

j) Money market funds – *AAA*

k) UK Government (including gilts and the DMADF)

l) Local authorities, parish councils etc

m) Supranational institutions

10.13. **Country and sector considerations:** Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition:

j) no more than 30% will be placed with any non-UK country at any time;

k) limits in place above will apply to a group of companies;

l) sector limits will be monitored regularly for appropriateness.

10.14. **Use of additional information other than credit ratings:** Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

10.15. **Time and monetary limits applying to investments:** The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch long term rating (or equivalent)	Money Limit	Time Limit
Banks 1 category high quality	*AA*	£15m	1yr
Banks 1 category lower quality	*A*	£10m	364 days
Banks 2 category – part nationalised	N/A	£15m	364 days
Limit 3 category – Council's banker (not meeting Banks 1)	A-	£5m	3 months
DMADF	AAA	unlimited	6 months
Local authorities	N/A	£10m per LA	5 years
Money market Funds	AAA	£5m per fund £25m overall limit	liquid

10.16. **Country limits:** The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

10.17. **Investment strategy:**

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2014. Bank Rate forecasts for financial year ends (March) are:

a) 2012/13 0.50%
b) 2013/14 0.50%
c) 2014/15 1.00%
d) 2015/16 1.50%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.

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

a) 2012/13 0.50%
b) 2013/14 0.50%
c) 2014/15 0.70%
d) 2015/16 1.50%

10.18. **Investment treasury indicator and limit:** Total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

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

Maximum Principle Funds invested >364 days			
£m	**2013/14**	**2014/15**	**2015/16**
Principal sums invested > 364 days	£20m	£20m	£20m

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts and short-dated deposits (overnight to three months), in order to benefit from the compounding of interest.

10.19. **Investment risk benchmarking:** These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

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

- 0.05% historic risk of default when compared to the whole portfolio; and
- in addition that the security benchmark for each individual year is:

	1 year	**2 years**	**3 years**	**4 years**	**5 years**
Maximum	**0.05%**	**0.04%**	**0.03%**	**0.02%**	**0.01%**

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

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

- Bank overdraft - £1.3m
- Liquid short term deposits of at least £1m available with a week's notice.
- Weighted average life benchmark is expected to be 0.45 years, with a maximum of 2.77 years.

Yield - local measures of yield benchmarks are

- Investments – internal returns above the 7 day LIBID rate

10.20. At the end of the financial year, the Council will report on its investment activity as part of its annual treasury management report.

11. Training

11.1. The training needs of treasury management officers are periodically reviewed.

12. Treasury Management Consultants

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

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Integrated impact assessment	NORWICH City Council

The IIA should assess **the impact of the recommendation** being made by the report

Detailed guidance to help with completing the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	Council
Committee date:	19 February 2013
Head of service:	Caroline Ryba
Report subject:	Treasury Management Strategy 2013-14
Date assessed:	
Description:	

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	X	☐	The report has no direct financial consequences however it does set the guidelines for how the Council manages its borrowing and investment resources
Other departments and services e.g. office facilities, customer contact	☐	☐	☐	
ICT services	☐	☐	☐	
Economic development	☐	☐	☐	
Financial inclusion	☐	☐	☐	
Social (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☐	☐	☐	
S17 crime and disorder act 1998	☐	☐	☐	
Human Rights Act 1998	☐	☐	☐	
Health and well being	☐	☐	☐	

	Impact			
Equality and diversity (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☐	☐	☐	
Eliminating discrimination & harassment	☐	☐	☐	
Advancing equality of opportunity	☐	☐	☐	
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☐	☐	☐	
Natural and built environment	☐	☐	☐	
Waste minimisation & resource use	☐	☐	☐	
Pollution	☐	☐	☐	
Sustainable procurement	☐	☐	☐	
Energy and climate change	☐	☐	☐	
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☐	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues

Appendix 1

Interest Rate Forecasts 2013 - 2015

Sector's Interest Rate View											
	Now	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
3 Month LIBID	0.40%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.70%	0.90%	1.10%	1.40%
6 Month LIBID	0.58%	0.85%	0.85%	0.85%	0.85%	0.85%	1.00%	1.10%	1.30%	1.50%	1.80%
12 Month LIBID	0.97%	1.30%	1.30%	1.30%	1.40%	1.50%	1.70%	1.90%	2.10%	2.30%	2.60%
5yr PWLB Rate	1.66%	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.30%
10yr PWLB Rate	2.67%	2.50%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.20%	3.30%
25yr PWLB Rate	3.88%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%
50yr PWLB Rate	4.03%	3.90%	3.90%	3.90%	4.00%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%
Bank Rate											
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
UBS	0.50%	0.25%	0.25%	0.25%	0.25%	0.25%	-	-	-	-	-
Capital Economics	0.50%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	-
5yr PWLB Rate											
Sector's View	1.66%	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.30%
UBS	1.66%	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.66%	1.20%	1.20%	1.20%	1.20%	1.20%	1.20%	1.30%	1.40%	1.50%	-
10yr PWLB Rate											
Sector's View	2.67%	2.50%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.20%	3.30%
UBS	2.67%	2.80%	3.00%	3.10%	3.20%	3.40%	-	-	-	-	-
Capital Economics	2.67%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-
25yr PWLB Rate											
Sector's View	3.88%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%
UBS	3.88%	4.00%	4.20%	4.30%	4.40%	4.50%	-	-	-	-	-
Capital Economics	3.88%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-
50yr PWLB Rate											
Sector's View	4.03%	3.90%	3.90%	3.90%	4.00%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%
UBS	4.03%	4.00%	4.20%	4.30%	4.40%	4.50%	-	-	-	-	-
Capital Economics	4.03%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-

Economic Background

Global economy

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

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

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

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

UK economy

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

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

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

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

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

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

Sector's forward view

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

- the potential for the unravelling of the second Greek bailout package causing a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;

- inter government agreement on how to deal with the Eurozone debt crisis could fragment; the impact of the Eurozone crisis on financial markets and the banking sector;

- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;

- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that are unlikely to be achieved;

- the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;

- stimulus packages failing to stimulate growth;

- elections due in the US and Germany in 2012 and 2013 respectively;

- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

- the potential for action to curtail the Iranian nuclear programme

- the situation in Syria deteriorating and impacting other countries in the Middle East

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

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

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

Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

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

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 22 March 2011 and will apply its principles to all investment activity. In accordance with the Code, the Chief Finance Officer has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

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

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

The investment policy proposed for the Council is:

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

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.

4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated *AAA* by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society For category 5 this covers bodies with a minimum short term rating of A- (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is:

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

	Non Specified Investment Category	**Limit (£ or %)**
a.	**Supranational bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£15m £15m
b.	**Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£15
c.	The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£5m
d.	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with	£10m or 1% of assets

	ratings. The Council may use such building societies which have a minimum asset size of £2bn but will restrict these type of investments to	
e.	Any **bank or building society** that has a minimum long term credit rating of A+/A,, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	Maximum Limit of 100%, so long as no more than 25% of investments have maturities of longer the one year at any one time.
f.	Any **non rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to having a minimum asset size of £250m and a restriction on the investment amount to 1% of its assets size.	£10m for a maximum of 3 months
g.	**Share capital *** in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies. There is a higher risk of loss with these types of instruments.	Nil
h.	**Pooled property funds** – The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. The key exception to this is an investment in the CCLA Local Authorities Property Fund.	Nil

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Finance Officer, and if required new counterparties which meet the criteria will be added to the list.

The treasury management role of the section 151 officer

The S151 (responsible) 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.