

**Report to** Cabinet  
5 February 2013  
**Report of** Chief Finance Officer  
**Subject** Treasury Management Strategy 2014-15

**Item**

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## **Purpose**

This report outlines the council's prudential indicators for 2014/15 through to 2016/17 and sets out the expected treasury operations for this period. It fulfils three key reports required by the Local Government Act 2003:

- The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The Minimum Revenue Provision (MRP) Policy, as required by Regulation under the Local Government and Public Involvement in Health Act 2007 (Appendix A); and
- 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:

- (1) The Capital Prudential Indicators and Limits for 2014/15 to 2016/17 contained within paragraphs 7 - 12 of this report;
- (2) The Borrowing Strategy 2014/15 to 2016/17 (paragraphs 21 – 24);
- (3) The Treasury Prudential Indicators (paragraphs 25 - 28), including the Authorised Limit (paragraph 26);
- (4) The Minimum Revenue Provision (MRP) policy statement contained in paragraph 13;
- (5) The Investment Strategy 2014/15 (paragraphs 29 – 52) 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

## **Contact officers**

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## **Background documents**

None

## Introduction

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.
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.
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."*

4. The Council initially adopted the CIPFA Code of Practice on 2 April 2002 and has, through the annual strategy, adopted any subsequent changes or revisions. The adoption of the Code of Practice and the requirement to follow the Code is a requirement under statutory instrument.

## The Treasury Management Policy Statement

The Council defines its treasury management activities as:

5. The management of the organisation'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.
6. 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, and any financial instruments entered into to manage these risks.
7. 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.

## Reporting requirements

8. The council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

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

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

9. The **treasury management strategy statement** 2014/15 covers the following areas:

#### **Capital**

- capital plans and prudential indicators
- minimum revenue provision (MRP) strategy

#### **Borrowing**

- current treasury management position
- prospects for interest rates
- borrowing strategy, including the policy on borrowing in advance of need and debt rescheduling
- treasury indicators: limits to borrowing activity and affordability, designed to limit the\* treasury risk to the council

#### **Investments**

- annual investment strategy
- creditworthiness policy

#### **Other**

- training
- 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.

#### **Capital**

##### **Capital plans and prudential indicators**

10. 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.
11. **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.

<b>Capital Expenditure £000</b>	<b>2012/13 Actual</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>
Non-HRA	6,196	8,767	29,311	29,525	22,950	1,618
HRA	24,568	33,266	42,551	52,273	39,211	28,232
<b>Total</b>	<b>30,764</b>	<b>42,033</b>	<b>71,862</b>	<b>81,798</b>	<b>62,161</b>	<b>29,850</b>

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

12. 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.

<b>Capital Funding £000</b>	<b>2012/13 Actual</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>
<b>Financed by:</b>						
Capital receipts	4,031	5,938	7,218	10,521	4,732	2,828
Capital grants	2,083	3,502	9,753	933	1,029	1,026
Reserves	23,553	17,574	16,923	12,336	12,346	12,312
Revenue	970	15,019	19,885	31,538	16,809	13,684
<b>Total resources</b>	<b>30,637</b>	<b>42,033</b>	<b>53,778</b>	<b>55,328</b>	<b>34,916</b>	<b>29,850</b>
<b>Net borrowing need for the year</b>	<b>127</b>	<b>-</b>	<b>18,084</b>	<b>26,470</b>	<b>27,245</b>	<b>-</b>

Capital expenditure 2014/15 will not agree to the capital programme presented to cabinet on 5 February 2014 as the figures in the table above include non-housing capital expenditure of £2.474m that is expected to be carried forward at the end of 2013/14 which has already been approved.

13. **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.
14. 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.
15. 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:

<b>Capital Financing Requirement £000</b>	<b>2012/13 Actual</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>
CFR Non-HRA	26,295	25,243	42,319	66,071	84,758	81,368
CFR HRA	211,569	211,569	211,567	212,593	218,508	218,508
<b>Total CFR</b>	<b>237,864</b>	<b>236,812</b>	<b>253,886</b>	<b>278,664</b>	<b>303,266</b>	<b>299,876</b>
<b>Movement in CFR</b>	(127)	(1,052)	17,074	24,778	24,602	(3,390)
<b>Movement in CFR is represented by</b>						
Net financing need for the year (above)	1,099	-	18,084	26,470	27,245	-
Less MRP/VRP and other financing movements	(968)	(1,052)	(1,010)	(1,692)	(2,643)	(3,390)
Movement in CFR	(127)	(1,052)	17,074	24,778	24,602	-

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

## **Minimum Revenue Provision (MRP) policy statement**

16. The council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP).

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

- For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be based on CFR. This provides for an approximate 4% reduction in the borrowing need (CFR) each year.
- 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.
- 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).
- Repayments included in annual finance leases are applied as MRP.

## **Borrowing**

### **Current treasury management position**

17. The treasury management function ensures that the council's cash is organised in accordance with 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 appropriate borrowing facilities.

18. The council's treasury portfolio position at 31 March 2013, 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.

<b>£000</b>	<b>2012/13 Actual</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>
<b>External debt</b>					
Debt at 1 April	242,348	223,917	223,917	243,917	263,817
Expected change in debt	(18,431)	-	20,000	19,900	29,200
Other long-term liabilities (OLTL)	2,143	2,075	2,003	1,928	1,847
Expected change in OLTL	(68)	(72)	(76)	(80)	(85)
<b>Debt at 31 March</b>	<b>225,992</b>	<b>225,920</b>	<b>244,844</b>	<b>265,664</b>	<b>294,779</b>
<b>Capital Financing Requirement (CFR)</b>	<b>237,864</b>	<b>236,812</b>	<b>253,886</b>	<b>278,664</b>	<b>303,266</b>
<b>Under / (over) borrowing</b>	<b>11,872</b>	<b>10,892</b>	<b>8,042</b>	<b>13,000</b>	<b>8,487</b>

19. 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 2014/15 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The 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.

### **Prospects for interest rates**

20. The council has appointed Capita Asset Services (formerly 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 Capita Asset Services central view.



Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2013	0.50	2.50	4.40	4.40
Mar 2014	0.50	2.50	4.40	4.40
Jun 2014	0.50	2.60	4.40	4.40
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.50	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.20	5.00	5.10
Jun 2016	0.50	3.30	5.10	5.20
Sep 2016	0.75	3.50	5.10	5.20
Dec 2016	1.00	3.60	5.10	5.20
Mar 2017	1.25	3.70	5.20	5.30

Further detailed interest rate forecasts are given in Appendix 1.

21. Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded in quarter 1 and 2 of 2013 to surpass all expectations. Growth prospects remain strong looking forward, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent.
22. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.
23. The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Although Eurozone concerns have subsided in 2013, Eurozone sovereign debt difficulties have not gone away and there are major concerns as to how these will be managed over the next few years as levels of government debt, in some countries, continue to rise to levels that compound already existing concerns. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2014/15 and beyond;
- Borrowing interest rates have risen significantly during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring even higher borrowing costs, which are now looming ever closer, where authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt, in the near future;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

Further detailed analysis of the current economic context is provided in Appendix 2.

### **Borrowing strategy**

24. The council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the CFR) 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.
25. Against this background and the risks within the economic forecast, caution will be adopted with the 2014/15 treasury operations. The Chief finance officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
  - *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
  - *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast*, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

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

26. **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.

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.

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

The reasons for any rescheduling to take place may include:

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility)

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

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

#### **Treasury indicators: limits on borrowing activity and affordability**

28. **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.

<b>Operational boundary £000</b>	<b>2012/13 Actual</b>	<b>2013/14 estimate</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>
Debt	223,917,	223917	243,917	263,817	293,017
Other Long term Liabilities	2,075	2,003	1,928	1,847	1,762
<b>Total</b>	<b>225,992</b>	<b>225,920</b>	<b>245,845</b>	<b>265,664</b>	<b>294,779</b>

29. **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.
- 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.
  - The council is asked to approve the following authorised limit:

<b>Authorised Limit £000</b>	<b>2012/13 Actual</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>
Debt	263,917	263,917	283,917	303,817	333,0172
Other Long term Liabilities	2,075	2,003	1,928	1,847	1,762
<b>Total</b>	<b>265,992</b>	<b>265,920</b>	<b>285,844</b>	<b>305,664</b>	<b>334,779</b>

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

<b>HRA debt limit £000</b>	<b>2012/13 Actual</b>	<b>2014/15 Estimate</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>
Total	236,989	236,989	236,989	236,989	236,989

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

- **Upper limits on variable interest rate exposure:** This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- **Upper limits on fixed interest rate exposure:** This is similar to the previous indicator and covers a maximum limit on fixed interest rates
- **Maturity structure of borrowing:** These gross limits are set to reduce the council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits

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

£m	2014/15	2015/16	2016/17
<b>Interest rate exposures</b>			
<b>Limits on fixed interest rates based on net debt</b>	100%	100%	100%
<b>Limits on variable interest rates based on net debt</b>	20%	20%	20%
<b>Limits on fixed interest rates:</b>			
• Debt only	100%	100%	100%
• Investments only	100%	100%	100%
<b>Limits on variable interest rates</b>			
• Debt only	20%	20%	20%
• Investments only	20%	20%	20%
<b>Maturity structure of fixed interest rate borrowing</b>			
	<b>Lower</b>	<b>Upper</b>	
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%	

31. **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.

%	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Non-HRA	8.96	4.64	8.64	13.49	13.95
HRA	12.84	12.13	11.77	11.55	11.21

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 2014/15 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.

## **Investments**

### **Annual investment strategy**

32. **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.

<b>Year end resources £000</b>	<b>2012/13 Actual</b>	<b>2014/15 Estimate</b>	<b>2014/15 Estimate</b>	<b>2015/16 Estimate</b>	<b>2016/17 Estimate</b>
Fund balances / reserves	32,983	32,516	24,091	10,141	10,006
Capital receipts	15,227	14,985	14,985	11,749	9,845
Provisions	-	-	-	-	-
Other	4,228	5,190	4,494	4,677	4,860
Working capital*					
<b>Expected investments</b>	<b>54,763</b>	<b>55,000</b>	<b>25,000</b>	<b>20,000</b>	<b>20,000</b>

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

33. **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 Capital Asset Services (formerly Sector)al Guidance Notes ("the CIPFA TM Code"). The council's investment priorities will be security first, liquidity second, then return.
34. 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 agency. Using the Capital Asset Services (formerly 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.
35. 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 Capital Asset Services (formerly 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.
36. Other information sources used will include the financial press, share price and other such information pertaining to the banking Capital Asset Services (formerly Sector) in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
37. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

38. The intention of the strategy is to provide security of investment and minimisation of risk.
39. 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.
40. **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.
41. 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.
42. 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 Capita Asset Services (formerly 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.
43. The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) are:
- Banks 1 - good credit quality – the council will only use banks which:
    - are UK banks; and/or
    - are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA
    - and have, as a minimum, the following Fitch, Moody's and Standard Poors credit ratings (where rated):
  - Short term - F1, P1, A1



- Long term – A, A2, A
- Viability / financial strength – bbb+ (Fitch / Moody's only)
- Support – 3(Fitch only)
- 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.
- 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.
- 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.
- Building societies The council will use all societies which:
  - meet the ratings for banks outlined above
  - have assets in excess of £2bn
  - or meet both criteria.
- Money market funds – AAA
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc
- Supranational institutions

44. **Country and Capita Asset Services (formerly Sector) considerations:** Due care will be taken to consider the country, group and Capita Asset Services (formerly 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:

- no more than 30% will be placed with any non-UK country at any time
- limits in place above will apply to a group of companies
- Capita Asset Services (formerly Sector) limits will be monitored regularly for appropriateness

45. **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.

46. **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):

	<b>Fitch long term rating (or equivalent)</b>	<b>Money Limit</b>	<b>Time Limit</b>
Banks 1 category high quality	AA	£15m	364 days
Banks 1 category lower quality	A	£10m	364 days
Banks 2 category – part nationalised	N/A	£15m	3yr
Limit 3 category – council's banker (not meeting Banks 1)	A-	£5m	3 months
Building Societies	Asset worth £2bn	£10m	364 days
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

47. **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.

### **Investment strategy**

48. **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).
49. **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 of 2016. Bank Rate forecasts for financial year ends (March) are:
- 2013/14 0.50%
  - 2014/15 0.50%
  - 2015/16 0.50%
  - 2016/17 1.25%

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 100 days during each financial year for the next four years are as follows:

- 2014/15 0.50%

- 2015/16 0.50%
- 2016/17 0.75%
- 2017/18 2.25%

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

The council is asked to approve the treasury indicator and limit:

Maximum Principle Funds invested >364 days			
£m	2014/15	2015/16	2016/17
Principal sums invested > 364 days	£15m	£15m	£15m

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.

51. **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.
52. **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
- in addition, that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
<b>Maximum</b>	<b>0.05%</b>	<b>0.04%</b>	<b>0.03%</b>	<b>0.02%</b>	<b>0.01%</b>

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

53. **Liquidity** – in respect of this area the council seeks to maintain:
- Bank overdraft – zero balance
  - 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

54. **Yield** - local measures of yield benchmarks are
- Investments – internal returns above the 7 day LIBID rate
55. At the end of the financial year, the council will report on its investment activity as part of its annual treasury management report.

### **Other**

#### **Training**

56. The CIPFA code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. Members received treasury management training from Capita's Richard Dunlop in November 2013 and further training will be arranged as required.
57. The training needs of treasury management officers are periodically reviewed.

#### **Treasury Management Consultants**

58. The council uses Capita Asset Services as its external treasury management advisors.
59. 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.
60. 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:	05 February 2014
Head of service:	Caroline Ryba
Report subject:	Treasury Management Strategy 2014-15
Date assessed:	
Description:	

	Impact			
Economic (please add an 'x' as appropriate)	Neutral	Positive	Negative	Comments
Finance (value for money)	<input type="checkbox"/>	X	<input type="checkbox"/>	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	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
ICT services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Economic development	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Financial inclusion	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Social (please add an 'x' as appropriate)	Neutral	Positive	Negative	Comments
Safeguarding children and adults	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
<u>S17 crime and disorder act 1998</u>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Human Rights Act 1998	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
Health and well being	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

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

**Recommendations from impact assessment**

**Positive**

**Negative**

**Neutral**

**Issues**



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

## Economic Background

### THE GLOBAL ECONOMY

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

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

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

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

promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

**Japan.** The initial euphoria generated by “Abenomics”, the huge QE operation instituted by the Japanese government to buy Japanese debt, has tempered as the follow through of measures to reform the financial system and introduce other economic reforms, appears to have stalled. However, at long last, Japan has seen strong growth of 4% in the first two quarters of 2013 which portends well for the hopes that Japan can escape from the bog of stagnation and help support world growth. The fiscal challenges though are huge; the gross debt to GDP ratio is about 245% in 2013 while the government is currently running an annual fiscal deficit of around 50% of total government expenditure. Within two years, the central bank will end up purchasing about Y190 trillion (£1,200 billion) of government debt. In addition, the population is ageing due to a low birth rate and will fall from 128m to 100m by 2050.

### THE UK ECONOMY

**Economic growth.** Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded in quarter 1 (+0.3%) and 2 (+0.7%) of 2013 to surpass all expectations as all three main sectors, services, manufacturing and construction contributed to this strong upturn. The August 2013 Bank of England Inflation Report consequently upgraded growth forecasts for 2013 from 1.2% to 1.4% and for 2014 from 1.7% to 2.5%. However, Bank Governor Mark Carney put this into perspective by describing this welcome increase as not yet being “escape velocity” to ensure we return to strong AND sustainable growth. So very encouraging - yes, but, still a long way to go! However, growth is expected to be strong for the immediate future. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth.

**Forward guidance.** The Bank of England also issued forward guidance with this Inflation Report which said that the Bank will not start to consider raising interest rates until the jobless rate (Labour Force Survey / ILO i.e. not the claimant count measure) has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years. The UK unemployment rate currently stands at 2.5 million i.e. 7.7 % on the LFS / ILO measure. The Bank's guidance is subject to three provisos, mainly around inflation; breaching any of them would sever the link between interest rates and unemployment levels. This actually makes forecasting Bank Rate much more complex given the lack of available reliable forecasts by economists over a three year plus horizon. The recession since 2007 was notable for how unemployment did NOT rise to the levels that would normally be expected in a major recession and the latest Inflation Report noted that productivity had sunk to 2005 levels. There has therefore been a significant level of retention of labour, which will mean that a significant amount of GDP growth can be accommodated without a major reduction in unemployment. The forecast in this report for Bank Rate not to start increasing until quarter 3 of 2016 is based on a slow reduction of unemployment, (in line with the Bank of England's forecast), and contrary to the prevalent market view where rates are indicating that Bank Rate is expected to start going up in early 2015.

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

**Inflation.** Inflation has fallen from a peak of 3.1% in June 2013 to 2.7% in September. It is expected to fall back to reach the 2% target level within the two year horizon.

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

### Capita Asset Services forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely during the remainder of 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds.

Near-term, there is some residual risk of further QE - if there is a dip in strong growth or if the MPC takes action to do more QE in order to reverse the rapid increase in market rates, especially in gilt yields and interest rates up to 10 years. This could cause shorter-dated gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below. The failure in the US, (at the time of writing), over passing a Federal budget for the new financial year starting on 1 October, and the expected tension over raising the debt ceiling in mid October, could also see bond yields temporarily dip until any binding agreement is reached between the opposing Republican and Democrat sides. Conversely, the eventual start of tapering by the Fed could cause bond yields to rise.

The longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in economic recovery is also likely to compound this effect as a continuation of recovery will further encourage investors to switch back from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently weighted to the upside after five months of robust good news on the economy. However, only time will tell just how long this period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

Downside risks currently include:

- The conflict in the UK between market expectations of how quickly unemployment will fall as opposed to the Bank of England's forecasts
- Prolonged political disagreement over the US Federal Budget and raising the debt ceiling
- A return to weak economic growth in the US, UK and China causing major disappointment to investor and market expectations.
- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- The Italian political situation is frail and unstable.
- Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- Weak growth or recession in the UK's main trading partners - the EU and US, depressing economic recovery in the UK.
- Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds

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

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

## **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-Capita Asset Services (formerly Sector)al 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.	<p><b>Supranational bonds greater than 1 year to maturity</b></p> <p><b>(a) Multilateral development bank bonds</b> - 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.).</p> <p><b>(b) A financial institution that is guaranteed by the United Kingdom Government</b> (e.g. The Guaranteed Export Finance Company {GEFCO})</p> <p>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.</p>	<p>£15m</p> <p>£15m</p>
b.	<p><b>Gilt edged securities</b> 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.</p>	£15
c.	<p>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.</p>	£5m
d.	<p><b>Building societies not meeting the basic security requirements under the specified investments.</b> 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</p>	£10m or 1% of assets

### Appendix 3

	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 <b>bank or building society</b> 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 <b>non rated subsidiary</b> 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.	<b>Share capital</b> * 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.	<b>Pooled property funds</b> – 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 Capita Asset Services (formerly 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.