ITEM NO. 8.1

Report of:	**Head of Finance**
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Portfolio Leader:	**Leader of the Council**
Key Decision:	**No**
Report Track:	**Cabinet: 30/01/14** **Council: 12/02/14**

CABINET

30 JANUARY 2014

TREASURY MANAGEMENT STRATEGY, MINIMUM REVENUE PROVISION POLICY AND ANNUAL INVESTMENT STRATEGY 2014-15

1 Purpose of Report

1.1 This report is presented to obtain the Council's approval to:-

- Prudential and Treasury indicators - setting of indicators to ensure that the capital investment plans of the Council are affordable, prudent and sustainable;
- The Minimum Revenue Provision (MRP) Policy;
- Treasury Management Strategy Statement for 2014/15 - to set treasury limits for 2014/15 to 2016/17 and to provide a background to the latest economic forecasts of interest rates;
- Annual Investment Strategy 2014/15 - to set out the strategy of investment of surplus funds.

2 Recommendation

2.1 To approve:-

(a) The Prudential and Treasury indicators;
(b) The MRP Policy Statement;
(c) The Treasury Management Policy;
(d) The Annual Investment Strategy for 2014/15.

3 Key Issues and Reasons for Recommendations

3.1 The CIPFA Treasury Management code requires that the Council's Treasury Management Strategy be approved by Council in advance of each financial year.

4 Relationship to Corporate Priorities

4.1 Treasury management and investment activity link in with all of the Council's priorities and their spending plans.

5 Report Detail

5.1 Background

5.1.1 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.

5.1.2 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.

5.1.3 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."

5.2 **Reporting Requirements**

5.2.1 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:

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

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

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

Scrutiny -The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Cabinet or Audit and Governance Committee.

5.2.2 The Council has adopted the following reporting arrangements in accordance with the requirements of the CIPFA Code of Practice:-

Area of Responsibility	Council/Committee	Frequency
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy	Full council	Annually in February each year
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy/Monitoring of Prudential Indicators	Full council	Mid year
Treasury Management Strategy/ Annual Investment Strategy/ MRP policy – updates or revisions at other times	Full council	As required
Annual Treasury Outturn Report	Audit and Governance Committee and Council	Annually by 30 September after the end of the year
Scrutiny of treasury management strategy	Cabinet	Annually in December/January before the start of the year

5.3 **Treasury Management Strategy for 2014/15**

5.3.1 The strategy for 2014/15 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

5.3.2 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.

5.4 Treasury Management Consultants

5.4.1 The Council uses Capita Asset Services Treasury Solutions (previously Sector) as its external treasury management advisors.

5.4.2 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.

5.4.3 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.

5.5 The Capital Prudential Indicators 2014/15 – 2016/17

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

5.6 Capital expenditure

5.6.1 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. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £m	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Environment	0.024	0.199	1.806	0.036	-
Housing	0.472	2.797	0.745	0.542	0.328
Culture and Sport	2.264	0.907	1.232	1.185	-
Economic Development and Planning	0.841	-	-	-	-
Corporate Improvement	0.026	0.200	0.300	-	-
Town Centre Regeneration	0.152	0.368	0.763	-	-
Non -HRA	**3.779**	**4.471**	**4.846**	**1.763**	**0.328**
HRA	**6.668**	**12.801**	**12.966**	**11.265**	**9.811**
Total	**10.447**	**17.272**	**17.812**	**13.028**	**10.139**

5.6.2 **Other long term liabilities**. The financing need excludes other long term liabilities, such leasing arrangements which already include borrowing instruments.

5.6.3 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need

Capital expenditure £m	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Non-HRA	**3.779**	**4.471**	**4.846**	**1.763**	**0.328**
HRA	**6.668**	**12.801**	**12.966**	**11.265**	**9.811**
Total	**10.447**	**17.272**	**17.812**	**13.028**	**10.139**
Financed by:					
Capital receipts	1.944	0.675	1.389	0.439	1.089
Capital grants	0.864	4.142	4.658	2.493	0.808
Major Repairs Reserve	4.393	3.211	3.203	3.223	3.272
Revenue	1.314	6.486	5.540	6.873	4.970
Net financing need for the year	**1.932**	**2.758**	**3.022**	**-**	**-**

5.7 The Council's borrowing need (the Capital Financing Requirement)

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

5.7.2 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.

5.7.3 The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £0.490m of such schemes within the CFR.

5.7.4 The Council is asked to approve the following CFR projections:

£m	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Capital Financing Requirement					
CFR – non housing	14.744	16.267	15.810	15.371	12.949
CFR - housing	81.249	82.007	85.029	85.029	85.029
Total CFR	**95.994**	**98.274**	**100.839**	**100.400**	**99.978**
Movement in CFR	**1.225**	**2.280**	**2.565**	**(0.439)**	**(0.422)**

Movement in CFR represented by					
Net financing need for the year	1.932	0.758	3.022	-	-
LAMS		2.000			
Less MRP and other financing movements	(0.707)	(0.478)	(0.457)	(0.439)	(0.422)
Movement in CFR	**1.225**	**2.280**	**2.565**	**(0.439)**	**(0.422)**

5.8 **Minimum revenue provision (MRP) policy statement**

5.8.1 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)..

5.8.2 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:

5.8.3 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP Policy will be existing practice and the MRP will follow the existing practice outlined in former CLG regulations. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

5.8.4 From 1 April 2008 for all unsupported borrowing (including finance leases) the MRP policy will be based on the Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the regulations.

5.8.5 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).

5.8.6 The Council is participating in the Local Authority Mortgage Scheme. Lloyds Bank PLC required a 5 year cash advance from the Council to match the 5 year life of the indemnity. The cash advance placed with the bank provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The cash advance is due to be returned in full at maturity, with interest paid annually. Once the cash advance matures and funds are returned to the Council, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (5 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

5.8.7 Repayments included in finance leases are applied as MRP.

5.9 Affordability prudential indicators

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

5.10 Ratio of financing costs to net revenue stream

5.10.1 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	3.8%	4.9%	4.8%	5.0%	4.8%
HRA	17.7%	17.1%	18.2%	18.1%	17.8%

5.11 Incremental impact of capital investment decisions on council tax

5.11.1 This indicator identifies the revenue costs associated with proposed changes to the three year capital programme 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.

£	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Council tax band D	£0.00	£0.00	£0.00	£0.00	£0.00

5.12 Estimates of the incremental impact of capital investment decisions on housing rent levels

5.12.1 Similar to the council tax calcualtion, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in the budget report compared to the Council's exisitng commitments and current plans, expressed as a discrete impact on weekly rent levels.

£	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Weekly housing rent	£0.00	£0.00	£0.00	£0.00	£0.00

5.13 HRA ratios

£	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
HRA debt £m	81.249	82.007	85.029	85.029	85.029
HRA revenues £m	19,132	19.262	19.923	20.436	20.787
Ratio of debt to revenues %	425%	426%	427%	416%	409%
Number of HRA dwellings	5,394	5,258	5,196	5,176	5,151
Debt per dwelling £	14,930	15,597	16,364	16,428	16,507

5.14 Borrowing

5.14.1 The capital expenditure plans set out in paragraph 5.6.1 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

5.15 Current portfolio position

5.15.1 The Council's treasury portfolio position at 31 March 2013, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
External Debt					
Actual gross debt at 31 March	88.839	91.574	94.613	94.610	94.607
The Capital Financing Requirement	95.994	98.274	100.839	100.400	99.978
Under / (over) borrowing	(7.155)	(6.680)	(6.226)	(5.790)	(5.371)

5.15.2 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

5.15.3 The Head of Finance 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 contained in the draft budget for 2014-15 to 2016-17.

5.16 Treasury Indicators: limits to borrowing activity

5.16.1 **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 £m	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Total	**98.274**	**100.839**	**100.400**	**99.978**

5.16.2 **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.

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

2. The Council is asked to approve the following authorised limit:

Authorised limit £m	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Total	103.270	106.289	105.447	105.447

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

HRA debt limit £m	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
HRA Debt cap	85.029	85.029	85.029	85.029
HRA CFR	82.007	85.029	85.029	85.029
HRA headroom	3.022	-	-	-

5.17 Prospects for interest rates

5.17.1 The Council has appointed Capita Asset Services 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 our 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

5.17.2 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 disposbale income and living standards are under pressure, although income tax cuts have ameliorated this to some extent.

5.17.3 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.

5.17.4 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, 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.

5.18 Borrowing strategy

5.18.1 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.

5.18.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2014/15 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

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

5.19 Treasury management limits on activity

5.19.1 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.

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

£m	2014/15	2015/16	2016/17
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	75%	75%	75%
Maturity structure of fixed interest rate borrowing 2014/15			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	100%
40 years to 50 years		0%	100%
Maturity structure of variable interest rate borrowing 2014/15			
		Lower	**Upper**
Under 12 months		0%	75%
12 months to 2 years		0%	75%
2 years to 5 years		0%	75%
5 years to 10 years		0%	75%
10 years to 20 years		0%	75%
20 years to 30 years		0%	75%
30 years to 40 years		0%	75%
40 years to 50 years		0%	75%

5.20 Policy on borrowing in advance of need

5.20.1 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.

5.21 Annual Investment Strategy

5.21.1 The Council's **investment policy** has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second and then return.

5.21.2 In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using our ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

5.21.3 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" (CDS) and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Capita Asset Services in producing its colour codings which show the varying degrees of suggested creditworthiness.

5.21.4 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.

5.21.5 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.

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

5.21.7 Investment instruments identified for use in the financial year are listed in appendix 5.3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

5.22 Creditworthiness policy

5.22.1 The Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

5.22.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow5 years *
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

5.22.3 The Capita creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue weighting to just one agency's ratings.

5.22.4 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1 There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

5.22.5 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of our creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

5.22.6 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government.Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *AA-* from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 3. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

5.23 Investment Strategy

5.23.1 **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).

5.23.2 **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%

5.23.3 There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

5.23.4 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%

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

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

Maximum principal sums invested > 364 days			
£m	2014/15	2015/16	2016/17
Principal sums invested > 364 days	£10m	£10m	£10m

5.23.6 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

5.24 End of year investment report

5.24.1 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

6 Implications

6.1 Financial

The financial implications have been referred to throughout the report.

6.2 Legal

The legal implications have been referred to throughout the report.

6.3 Human Resources

There are no human resource implications arising from this report.

6.4 Section 17 (Crime Prevention)

There are no implications arising from this report.

6.5 Human Rights Act

There are no identified implications in respect of the Human Rights Act 1998 arising from this report.

6.6 Data Protection

There are no implications arising from this report.

6.7 Risk Management

The Council regards security of the sums it invests to be the key objective of its treasury management activity. Close management of counterparty risk is therefore a key element of day to day management of treasury activity. The practices designed to ensure that risks are managed effectively are set out in the Treasury Management Practices available on the Council's website.

6.8 Equality & Diversity

There are no identified implications arising form this report.

6.9 **Best Value**

The strategy ensures that best value is provided to the Council.

7 Appendices to the Report

Appendix 1	Economic Background
Appendix 2	Treasury Management Practice (TMP 1) – Credit and Counterparty Risk Management
Appendix 3	Approved Countries for Investment

Previous Consideration

FINANCIAL PLAN 2014/15 – 2016/17   21 November 2013

Previous Consideration

Background Papers

Available in Financial Services

APPENDIX 1

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% year on year 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.

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. 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 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. 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
- 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.

APPENDIX 2

TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. A maximum of 50% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	100%	6 months
UK Government Treasury blls	UK sovereign rating	£5million	6 months
Money market funds	AAA	£5million	Liquid
Enhanced money market funds with a credit score of 1.25	AAA	£5 million	Liquid
Enhanced money market funds with a credit score of 1.5	AAA	£5 million	Liquid
Local authorities	N/A	£5 million	2 years
Term deposits with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	£5 million	Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 100 days Not for use
CDs or corporate bonds with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	£5 million	Up to 5 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 100 days Not for use
Term Deposits with part nationalised banks	Blue	£6.0 million	Up to 1 year
Local Authority Mortgage Scheme. Under this scheme the Council is required to place funds of £2 million, with Lloyds Bank plc for a period of 5 years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the Specified / Non specified categories.			

NON-SPECIFIED INVESTMENTS: A maximum of 50% will be held in aggregate in non-specified investment

1. Maturities of ANY period

	Minimum Credit Criteria	Max % of total investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: - Structured deposits	See note 1	50%	Up to 1 year
Commercial paper issuance covered by a specific UK Government (explicit) guarantee	UK sovereign rating	50%	Up to 1 year
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	UK sovereign rating or	50%	Up to 1 year

APPENDIX 3

APPROVED COUNTRIES FOR INVESTMENT

AAA

- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- France
- Hong Kong
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)

AA-

- Belgium
- Saudi Arabia