BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM 6**

Resources Committee **19 March 2014**

Report of the Head of Finance

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY 2013/14

1 Purpose of Report

1.1 The Council is debt free and has no borrowing; however, it does have significant investments which earn interest that contributes to its overall income to fund services. The Council follows the Chartered Institute for Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice (the Code). The Council has adopted the requirements of the code, as part of its Financial Regulations, and this report sets out policies and strategies which it needs to approve in order to comply fully with the Code.

1.2 The report also sets out the Treasury Indicators for Members to monitor the Council's performance over the coming financial year. This is a mandatory requirement.

2 Executive Summary

2.1 This report forms an essential and mandatory part of the Council's Treasury Management process, and provides the Resources Committee with the opportunity to approve/amend the policy and performance indicators as outlined in the report.

3 Appendices

Appendix A Treasury Management Strategy Statement incorporating Minimum Revenue Provision Policy Statement and Annual Investment Strategy.

4 Proposed Action:

The Committee is invited to RECOMMEND

4.1 That the Council approves the Treasury Management Policy Statement set out in Appendix A of the report.

4.2 That the Council approves the Prudential and Treasury indicators as set out in Appendix A

4.3 That the Annual Investment Strategy included in Appendix A is approved.

4.4 Note the Council has previously formally adopted the clauses from the 2011 CIPFA Treasury Management Code of Practice

5 Background

The Revised CIPFA Treasury Management Code of Practice 2011.

5.1 The Council adopted the revised Treasury Management in the Public Services Code of Practice (the code) in March 2010 and adopted updates in 2011. There have been no further updates for 2012.

5.2 The Code emphasises a number of key areas of best practice to help limit the potential for loss, including the following:

a) All Councils must formally adopt the revised Code and four clauses.

b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities.

c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.

d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.

e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support.

f) Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits.

g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.

h) The main annual treasury management reports and in-year updates must be approved by full Council.

i) There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.

j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body. This is the Resources Committee at this council and also a role for the Overview and Scrutiny Committee.

k) Treasury management performance and policy setting should be subjected to prior scrutiny.

l) Members should be provided with access to relevant training.

m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

n) Responsibility for these activities must be clearly defined within the organisation.

o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices).

5.3 The attached strategy statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy will be approved annually by the Council and there will also be a mid year report. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting. For Wellingborough the following reporting arrangements are to be put in place in accordance with the requirements of the revised Code:

Area of Responsibility	**Council/ Committee/ Officer**	**Frequency**
Treasury Management Strategy / Annual Investment Strategy / Minimum Revenue Provision (MRP) policy	Resources Committee recommends to Council	March
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Resources Committee recommends to Council	October
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Resources Committee recommends to Council	December
Annual Treasury Outturn Report	Resources Committee recommends to Council	Annually by 30 September after the end of the year
Treasury Management Practices	Section 151 Officer	Updated on an ongoing basis as appropriate

CIPFA Prudential Code

5.4 Included in the report are the CIPFA Treasury Management Indicators which are part of the Prudential Code on Local Authority borrowing These indicators are :

- authorised limit for external debt
- operational boundary for external debt
- actual external debt.

All indicators have to be presented together as one suite. In addition, where there is a significant difference between the net and the gross borrowing position, the risks and benefits associated with this strategy should be clearly stated in the annual strategy.

Balanced Budget Requirement

5.5 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

6 Treasury Management Strategy for 2014-15

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council capital investment plans are affordable, prudent and sustainable. The Act requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy setting out the Council's policies for managing its investments for giving priority to the security and liquidity of those investments.

The recommended strategy for 2014-15 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Capita Asset Services (appointed by tender). The Strategy Covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- Prudential and Treasury Indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- the investment strategy
- creditworthiness policy
- policy on use of external service providers

6.1 Treasury Limits for 2014-15 to 2015/16

6.1.1 It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

6.1.2 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax level is 'acceptable'.

6.1.3 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in appendix A of this report. This shows that the budget plans for the Borough of Wellingborough are to remain debt free and thus borrowing to remain at nil. Provision has been made however for the Council's agreed £50,000 overdraft limit and up to £5m emergency temporary borrowing.

6.2 Prudential and Treasury Indicators for 2014-15 – 2015/16

6.2.1 Prudential and Treasury Indicators are needed for the purposes of setting an integrated treasury management strategy. The Borough of Wellingborough remains debt free under the 2014-15 to 2017-18 Medium Term Financial Plan.

6.2.2 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the full Council, and its subsequent updates have been adopted.

6.3 Current Treasury position

6.3.1 The Council's investment policy was reviewed, as part of the 2013/14 budget setting. Section 6.8 of this report sets out details of the basis for approving the institutions which the Council invests its funds with.

6.3.2 The in-house funds available for investment are largely cash flow and the capital receipts generated from the sale of assets. The Council's treasury investment portfolio position at 27th February 2014 comprised:

Table 1	Principal	Ave rate
	£m	%
Gross Debt	0	0
Total Investments	25.5	0.75

6.3.3 Funds available for investment have been estimated as part of the Council's medium term budget projections. These estimates assume that capital receipts are realised and include the use of funds to finance the capital programme and use of revenue balances to meet revenue expenditure as required by the financial strategy, as follows:

2013/14	2014/15	2015/16	2016/17
£'000	£'000	£'000	£'000
24,330	17,974	13,675	12,504

6.4 Borrowing Requirement

6.4.1 The medium term financial plan assumes no borrowing requirement and is in line with previous decisions to maintain a debt free position.

6.5 Prospect for Interest Rates.

6.5.1 The Council appointed by tender, Capita Asset Services, as treasury advisor to the Council, and part of this service is to assist the Council to formulate a view on interest rates. From a review of a number of current City forecasts for short term (Bank Rate) and longer fixed term interest rates. The current unpredictable nature of the market beyond the next two years for investment, being a debt free authority, shows that Sector's central view for that period is as follows:

Capita Bank Rate forecast for financial year ends (March)

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

6.5.2 For the purposes of 2014-15 Budget the level of investment income assumed has been based on an average return of 0.5% for new investments. This is in line with this advice and reflects current investment returns.

6.6 Borrowing Strategy

6.6.1 The Council is currently debt free and it is the intention that this will remain so in the medium term financial plan.

6.7 Policy on Borrowing in advance

6.7.1 As the Council plans to remain debt free, then it has no proposals to borrow and would not borrow in advance.

6.8 Annual Investment Strategy

- *Investment Policy*

6.8.1 The Council has regard to the DCLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised

CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”). The Council’s investment priorities are: -

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

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

6.8.3 Investment instruments identified for use in the financial year are listed in Appendix A. This list provides a guide as to which institutions are suitable to use but it will be amend as criteria of institutions change during the course of the year. The key drivers as to which institutions are suitable are as per paragraph 6.9.4, but officers also ensure the overall creditworthiness policy is applied.

6.8.4 Investments will accordingly 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).

6.9 Creditworthiness policy

6.9.1 As part of considering the 2013/14 Treasury Strategy, officers in conjunction with advice from the Council’s treasury advisors, have reviewed the list of financial institutions with whom the Council places investments and associated investment periods to ensure the approach is both robust and prudent. Additional banks have been added to the list to provide a wider range of investment opportunities in the banking sector.

6.9.2 This Council uses the creditworthiness service provided by Capita Asset Services, its current treasury management advisors. This service uses a sophisticated modeling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

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

6.9.3 The Council’s investment decisions are based on comparisons between the changes priced into market rates against the Council’s and advisor’s own forecasts. The section 151 officer, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the relevant risks.

6.9.4 All investments will also be made in accordance with the Government's investment guidelines. The classes of institution proposed for inclusion in the Council's counterparty investment list are as follows: -

- UK domiciled banks, with a minimum long term fitch rating of A-,
- Buildings societies with assets > 1bn
- Non UK banks, domiciled in a country which has a minimum sovereign long term fitch rating of AA- (or equivalent)
- Other local authorities and Government gilts,
- Money market funds (cash is invested with a fund holder).

6.9.5 Credit ratings are used by investors as indications of the likelihood of getting their money back in accordance with the terms on which they were invested. For short term investments (maximum 1 year) FITCH IBCA rate each organisations by one of the following:

F1+	exceptionally strong credit quality
F1	high credit quality
F2	good credit quality
F3	fair credit quality
B	some risk of default
C	high risk of default
D	will, or has already defaulted

Long-term ratings are also provided with "AAA" being the strongest and "D" the weakest.

- **Country Limits**

6.9.6 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). This list will be added to or deducted from by officers should ratings change in accordance with this policy.

- **Levels of investment**

6.9.8 To manage the Council's risk, it currently applies an overall limit of no more than 25% of the total investments per institution and institution group. Subject to this the following individual limits are applied:

- **Banks**

Part nationalised banks have the highest limits of £5m. The remaining UK domiciled banks have limits between £2m to £3m which is influenced by a variety of factors including the fitch long term and short term rating and credit default swaps data. The list of banks has been increased to provide a wider opportunity of potential investments.

- **Building Societies**

  Recent history suggests traditional Building Societies represent a relatively secure component of the financial markets. The institutions that have fallen into crisis are the banks and some of the Building Societies which have demutualised and followed a more risky business model.

  In addition the larger Building Societies have a history of buying out any of the smaller societies if they encounter difficulties. The Nationwide Building Society, which does carry a very strong credit rating is many times the size of the next largest society, and larger than all the other societies combined, and in the past has provided stability within the sector. It cannot however be assumed that the Nationwide will automatically support failing societies in the future. The Council's Treasury Management advisors, Capita asset services are currently advising that councils use only the Nationwide Building Society. In practice this would be very restrictive and the advice is not intended to be prescriptive. The strategy over the past year has been to reduce the number of investments with the building societies. Currently the list of building societies available to invest with has increased as there are currently more societies which hold asset over £1bn. However the actual values of investments placed with building societies has decreased. Current policy is to ensure the level of investments with the building societies, is limited, to no more than £20m of the council's investments.

  The reduction in value of investments with building society counterparties is leading to some reduction in the average interest return achieved by officers, which will affect the rates potentially achieved in 2014-15 and future periods.

- **Local Authorities**

  A limit of £5m has been applied to other local authorities and / or Government backings such as Gilts. This is in line with the maximum risk exposure to the highest rated financial institutions.

6.9.9 All credit ratings will be monitored continually**.** The Council is alerted to changes to ratings of all three agencies through its use of the Sector 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, and any existing investments will be immediately reviewed.

6.10 Policy on the use of external service providers

6.10.1 The Council uses Capita Asset Services as its external treasury management advisers. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

6.10.2 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.

6.10.3 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.

6.11 Scheme of delegation

6.11.1 In addition to the Strategy there is a need for the treasury management function to be operated accordingly and with due regard to the Code of Practice. As such the delegations covering the management of this area are set out clearly in the Council's Financial Procedure Rules.

7 Legal Powers

7.1 Local Government Act 2003

8 Financial and Value For Money Implications

8.1 There are no financial implications as a direct result of this report other than those noted in the body of the report and already accounted for in the 2014-15 budget.

9 Risk Analysis

Nature of risk	**Consequences if realized**	**Likelihood of occurrence**	**Control measures**
Unexpected fall in interest rates	Reduced income	Medium / High	Mix of short and longer term, fixed and variable rate investments.
Less funds available for investment	Reduced income	Medium / High	Regular budget monitoring allowing for remedial action to be taken.
Loss of capital	Reduced funds available for both capital and revenue purposes	Low	Financial ratings of counterparties and limits on amounts invested.

10 Implications for Resources

No direct implications.

11 Implications for Stronger and Safer Communities

No direct implications

12 Implications for Equalities

No direct implications

13 Author and Contact Officer

Liz Elliott Head of Finance

14 Consultees

SMT.

15 Background Papers

The CIPFA Prudential Code for Capital Finance in Local Authorities
CIPFA Code of Practice for Treasury Management in the Public Services.

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Borough Council of Wellingborough
2014-15

1 INTRODUCTION

1.1 Background

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.

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.

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."*

1.2 Reporting requirements

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

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.

1.3 Treasury Management Strategy for 2014-15

The strategy for 2014-15 covers two main areas:

Capital issues

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

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.

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.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. The last member training was on the 8th December 2011 and future training will be organised within the next financial year.

2 THE CAPITAL PRUDENTIAL INDICATORS 2014/15 – 2016/17

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

2.1 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.

Other long term liabilities.

The financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. The council has two finance leases which effectively include borrowing instruments.

The table below summarises the 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					
Total	3.740	2.623	9.253	2.305	0.775
Financed by:					
Capital receipts	0.831	1.400	1.700	1.250	1.250
Capital grants	0.353	0.465	0.636	0.634	0.513
Capital reserves	2.556	0.758	6.917	0.421	-0.988
Revenue					
Net financing need for the year	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**

2.2 The Council's 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 above, which has not immediately been paid for, will increase the CFR.

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.

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 £0.318m of such schemes within the CFR.

£m	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Capital Financing Requirement					
Total CFR	**-8.540**	**-8.683**	**-8.684**	**-8.685**	**-8.686**
Movement in CFR	**-0.169**	**-0.143**	**-0.001**	**-0.001**	**-0.001**

Movement in CFR represented by					
Net financing need for the year (above)					
Less MRP/VRP and other financing movements	-0.169	-0.143	-0.001	-0.001	-0.001
Movement in CFR	**-0.169**	**-0.143**	**-0.001**	**-0.001**	**-0.001**

2.3 Minimum revenue provision (MRP) policy statement

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*:*

The Council will make provision in its revenue accounts each year to meet the costs of the Principal element of the finance lease

2.4 Core funds and expected investment balances

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

Year End Resources £m	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Fund balances / reserves	7.500	5.500	4.000	2.500	1.750
Capital receipts	15.465	13.142	8.286	5.487	5.066
Provisions	0	0	0	0	0
Other	0.621				
Total core funds	**23.586**	**18.642**	**12.286**	**7.987**	**6.816**
Working capital*	**-3.047**	**-3.000**	**-3.000**	**-3.000**	**-3.000**
Under/over borrowing	8.688	8.688	8.688	8.688	8.688
Expected investments	**29.227**	**24.330**	**17.974**	**13.675**	**12.504**

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

2.5 Affordability prudential indicators

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:

2.6 Ratio of financing costs to net revenue stream.

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

%	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Non-HRA	-4.94	-4.14	-4.79	-6.74	-7.55

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

2.7 Incremental impact of capital investment decisions on council tax.

This indicator identifies the revenue costs associated with proposed changes to the capital programme recommended in this 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 the same period.

Incremental impact of capital investment decisions on the band D council tax

£	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Council tax - band D	0	0	0	0	0

3 BORROWING

The capital expenditure plans set out in Section 2 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 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 approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

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					
Debt at 1 April					
Expected change in Debt					
Other long-term liabilities (OLTL)	-0.317	-0.148	-0.005	-0.004	-0.003
Expected change in OLTL	0.169	0.143	0.001	0.001	0.001
Actual debt at 31 March	**-0.148**	**-0.005**	**-0.004**	**-0.003**	**-0.002**
The Capital Financing Requirement					
Under / (over) borrowing	- 8.688	-8.688	-8.688	-8.688	-8.688

Total investments at 31 March					
Investments	**29.227**	**23.534**	**18.538**	**14.630**	
Investment change		-5.693	-4.996	-3.908	

Net Debt	**-**	**-**	**-**	**-**	**-**

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 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 in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

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	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	0.050	0.050	0.050	0.050
Other long term liabilities	0.148	0.005	0.004	0.002
Total	0.198	0.055	0.054	0.052

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	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	5.050	5.050	5.050	5.050
Other long term liabilities	0.148	0.005	0.004	0.002
Total	5.198	5.055	5.054	5.052

3.3 Prospects for interest rates

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	4.50	4.50
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.60	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.10	5.00	5.10
Jun 2016	0.75	3.20	5.10	5.20
Sep 2016	1.00	3.30	5.10	5.20
Dec 2016	1.00	3.40	5.10	5.20
Mar 2017	1.25	3.40	5.10	5.20

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during2013 to surpass all expectations. Growth prospects remain strong for 2014, 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. 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. There are, therefore, concerns that a UK recovery currently based mainly on consumer spending and the housing market, may not endure much beyond 2014. 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.

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 to GDP ratios, in some countries, continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. 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.

3.4 Borrowing strategy

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.

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:

- *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.

Treasury management limits on activity

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	2013/14	2014/15	2015/16
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on variable interest rates: Debt/Investments	50%	50%	50%

3.5 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.

3.6 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 will 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

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

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

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

Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

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.

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

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

Investment instruments identified for use in the financial year are listed in appendices under the 'specified' and 'non-specified' investments categories. This list provides a guide as to which institutions are suitable to use during the year. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 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.

The Head of Finance 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.

All investments will be made in accordance with the Government's investment guidelines. The classes of institutions proposed for inclusion in the council's counterparty investment lists are as follows :-

- UK domiciled banks, with a minimum long term fitch rating of A-
- Non UK banks, domiciled in a country which has a minimum sovereign long term fitch rating of AA-
- Building societies with assets > 1bn
- Money market funds – (cash is invested with a fund holder)
- Other Local authorities and Government Gilts

4.3 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 or equivalent. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.4 Investment strategy

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

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2 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 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.

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	1.00%
2017/18	2.00%

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	**2013/14**	**2014/15**	**2015/16**
Principal sums invested > 364 days	£14m	£8m	£5m

4.5 End of year investment report

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

5 APPENDICES

(These can be appended to the report or omitted as required)

1. Interest rate forecasts
2. Economic background
3. Treasury management practice 1 – credit and counterparty risk management
4. Treasury management scheme of delegation
5. The treasury management role of the section 151 officer

5.1 APPENDIX: Interest Rate Forecasts 2014 - 2017

Capita Asset Services Interest Rate View	Now	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%	0.75%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.40%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%	1.20%	1.50%	1.70%
6 Month LIBID	0.49%	0.60%	0.60%	0.60%	0.60%	0.60%	0.70%	0.80%	1.00%	1.20%	1.30%	1.50%	1.70%	2.00%
12 Month LIBID	0.78%	0.80%	0.80%	0.80%	0.80%	0.90%	1.10%	1.20%	1.40%	1.60%	1.70%	1.90%	2.10%	2.30%
5yr PWLB Rate	2.63%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%
10yr PWLB Rate	3.66%	3.70%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.50%
25yr PWLB Rate	4.32%	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.90%	5.00%	5.00%	5.10%	5.10%	5.10%
50yr PWLB Rate	4.29%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%
Bank Rate														
Capita Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	-	-	-	-	-
5yr PWLB Rate														
Capita Asset Services	2.63%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%
UBS	2.63%	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	2.63%	2.60%	2.60%	2.60%	2.60%	2.70%	2.80%	3.00%	3.20%	-	-	-	-	-
10yr PWLB Rate														
Capita Asset Services	3.66%	3.70%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.50%
UBS	3.66%	3.70%	3.80%	3.90%	4.05%	4.05%	4.30%	4.55%	4.55%	-	-	-	-	-
Capital Economics	3.66%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	4.05%	-	-	-	-	-
25yr PWLB Rate														
Capita Asset Services	4.32%	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.90%	5.00%	5.00%	5.10%	5.10%	5.10%
UBS	4.32%	4.55%	4.55%	4.80%	4.80%	5.05%	5.05%	5.30%	5.30%	-	-	-	-	-
Capital Economics	4.32%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.45%	-	-	-	-	-
50yr PWLB Rate														
Capita Asset Services	4.29%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%
UBS	4.29%	4.45%	4.45%	4.70%	4.70%	4.90%	4.90%	5.05%	5.05%	-	-	-	-	-
Capital Economics	4.29%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.60%	-	-	-	-	-

5.2 APPENDIX: Economic Background

THE GLOBAL ECONOMY

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

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

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

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

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

THE UK ECONOMY

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

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

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

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

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

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

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

Capita Asset Services forward view

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

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

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

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

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

Downside risks currently include:

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

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

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

5.3 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 2 years**, 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 75% 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 below categories. In addition to the Fitch rating, credit default swaps are consider in assessing the suitablility of institutions.

Specified Investments (max 12mnths)

Counterparty	**Recommended Investment Limit**	**Ftich Long Term**	**Fitch Short Term**
Bank of Scotland (Lloyds Grp)	£5m	A	F!
Lloyds TSB (Lloyds Grp)	£5m	A	F1
Royal Bank of Scotland (RBS Grp)	£5m	A	F1
National Westminster Bank (RBS Grp)	£5m	A	F1
Ulster Bank (RBS Grp)	£3m	A-	F1
Nationwide	£3m	NA	NA
Bank of New York Melllon (International)	£3m	AA-	F1+

Barclays Bank	£2m	A	F1
Citibank International	£3m	A	F1
Clydesdale Bank	£3m	A	F1
Credit Suisse International	£3m	A	F1
HSBC Bank	£2m	AA	F1+
MBNA Europe	£3m	A	F1
Standard Chartered Bank	£2m	AA-	F1+
Sumitomo Mitsui Banking Corp	£2m	A-	F1
UBS Ltd	£3m	A	F1

Non Specified Investments

Counterparty	Recommended Investment Limit	Ftich Long Term	Fitch Short Term
Bank of Scotland (Lloyds Grp)	£5m	A	F!
Lloyds TSB (Lloyds Grp)	£5m	A	F1
Royal Bank of Scotland (RBS Grp)	£5m	A	F1
National Westminster Bank (RBS Grp)	£5m	A	F1

Ulster Bank (RBS Grp)	£3m	A-	F1
Nationwide	£3m	NA	NA
Bank of New York Melllon (International)	£3m	AA-	F1+
Barclays Bank	£2m	A	F1
Citibank International	£3m	A	F1
Clydesdale Bank	£3m	A	F1
Credit Suisse International	£3m	A	F1
HSBC Bank	£2m	AA	F1+
MBNA Europe	£3m	A	F1
Standard Chartered Bank	£2m	AA-	F1+
Sumitomo Mitsui Banking Corp	£2m	A-	F1
UBS Ltd	£3m	A	F1

Building Societies	**Recommended Investment Limit**		
Yorkshire	£3m		
Coventry	£3m		
Skipton	£3m		
Leeds	£3m		
West Bromwich	£2m		
Principality	£2m		
Newcastle	£2m		
Nottingham	£2m		
Progressive	£1m		
Cumberland	£1m		
National Counties	£1m		
Saffron	£0.5m		
Cambridge	£0.5m		

APPENDIX: Approved countries for investments

AAA

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

AA+

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

AA

- Abu Dhabi
- Qatar
- UAE

AA-

- Belgium
- Japan
- Saudi Arabia

5.4 APPENDIX: Treasury management scheme of delegation

(i) Full board/council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

5.5 APPENDIX: 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.