COVERING SHEET

Report to:Cabinet **Date**: 04 February 2015

Subject: Treasury Management Strategy

IMPORTANT

Please update the following as you progress the report, otherwise the assumption will be that none of the following have been consulted:

	Applicable for this report?	Informed / consulted?	Cleared?
Finance	Yes	Yes	Yes
HR	No	No	No
Monitoring officer	No	No	No
Legal	No	No	No
Communications (inc reputational)	No	No	No
UNISON	No	No	No

Report has been cleared by Head of service Yes

Report has been cleared by Deputy chief executive /Executive head No

Report to	Cabinet	**Item**
	4 February 2015	
Report of	Chief Finance Officer	
Subject	Treasury Management Strategy 2015-16	

Purpose

This report outlines the council's prudential indicators for 2015/16 through to 2017/18 and sets out the expected treasury operations for this period. It fulfils three key reports required by the Local Government Act 2003:

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

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

Recommendation

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

1. The Capital Prudential Indicators and Limits for 2015/16 through to 2017/18 contained within paragraphs 7 - 12 of this report
2. The Borrowing Strategy 2015/16 through to 2017/18 (paragraphs 21 – 24)
3. The Treasury Prudential Indicators (paragraphs 25 - 28), including the Authorised Limit (paragraph 26)
4. The Minimum Revenue Provision (MRP) policy statement contained in paragraph 13
5. The Investment Strategy 2015/16 (paragraphs 29 – 52) and the detailed criteria included in Appendix 3

Corporate and service priorities

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

Financial implications

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

Ward/s: all wards

Cabinet member: Councillor Waters – Deputy leader and resources

Contact officers

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Background documents

None

Introduction

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

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

3. CIPFA defines treasury management as:

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

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

The Treasury Management Policy Statement

The council defines its treasury management activities as:

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

6. The council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

7. The council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Reporting requirements

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

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

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

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

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

9. The **treasury management strategy statement** 2015/16 covers the following areas:

Capital

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

Borrowing

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

Investments

- annual investment strategy
- creditworthiness policy

Other

- training
- policy on use of external service providers

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

<u>Capital</u>

Capital plans and prudential indicators

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

11. **Capital expenditure:** This prudential indicator is a summary of the council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure £000	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Non-HRA	6,868	10,830	21,565	28,178	14,316	3,122
HRA	27,180	35,809	44,180	42,272	27,900	26,405
Total	**34,048**	**46,639**	**65,745**	**70,450**	**42,216**	**29,527**

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

Capital expenditure for 2015/16 differs from the proposed capital programme as the figures in the table above include non-housing capital expenditure of £10.167m that is expected to be carried forward at the end of 2014/15 which has already been approved and is therefore not included in the capital programme to be approved.

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

Capital Funding £000	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Financed by:						
Capital receipts	3,542	4,806	4,673	3,869	3,439	3,086
Capital grants and contributions	2,324	8,307	7,751	2,885	2.664	2,444
Reserves	13,042	16,611	13,186	2,254	5,984	10,956
Revenue	17,028	19,885	19,885	11,945	12,396	13,041
Total resources	**35,936**	**46,639**	**51,824**	**20,953**	**24,483**	**29,527**
Net borrowing need for the year	**(1,888)**	**-**	**13,921**	**49,497**	**17,733**	**-**

13. **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 which has not immediately been paid for will increase the CFR.

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

15. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the council's borrowing requirement, these types of scheme include a borrowing facility and so the council is not required to separately borrow for these schemes. The council currently has £1.27m of such schemes within the CFR.

The council is asked to approve the CFR projections below:

Capital Financing Requirement £000	**2013/14 Actual**	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
CFR Non-HRA	26,925	27,515	39,109	62,367	71,439	68,175
CFR HRA	209,051	207,384	208,611	233,285	239,451	238,858
Total CFR	**235,976**	**234,899**	**247,719**	**295,652**	**310,890**	**307,183**
Movement in CFR	(2,940)	(1,077)	12,820	47,933	15,238	(3,858)
Movement in CFR is represented by						
Net financing need for the year (above)	(1,888)	-	13,921	49,433	17,733	-
Less MRP and other financing movements	(1,052)	(1,077)	(1,101)	(1,564)	(2,495)	(3,858)
Movement in CFR	(2,940)	-	12,820	47,933	15,238	-

Note: the MRP includes finance principle payments.

The CFR above makes no assumptions about selling any of the properties built or of any special purpose vehicle usage for the building of the properties. Part of the CFR movement on 2018/19 relates to the repayment of the LAMS indemnity funding of £1m.

Minimum Revenue Provision (MRP) policy statement

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

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

- For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be based on CFR. This provides for an approximate 4% reduction in the borrowing need (CFR) each year.
- From 1 April 2008 for all unsupported borrowing, the MRP policy will be based on CFR. This provides for an approximate 4% reduction in the borrowing need (CFR) each year.
- There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).
- Repayments included in annual finance leases are applied as MRP.

For authorities, like Norwich, which participate in LAMS using the cash backed option, the mortgage lenders require a 5 year cash advance from the local authority to match the 5 year life of the indemnity. The cash advance placed with the mortgage lender provides an integral part of the mortgage lending, and should therefore be 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 local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (5 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The position should be reviewed on an annual basis.

<u>Borrowing</u>

Current treasury management position

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

18. The council’s treasury debt portfolio position at 31 March 2014, with forward projections, is summarised below. The table shows the actual external debt (treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£000	**2013/14 Actual**	**2014/15 Forecast**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
External debt						
Debt at 1 April	223,917	223,917	223,917	232,777	271,524	282,257
Expected change in debt	-	-	8,860	38,747	10,733	(2,000)
Other long-term liabilities (OLTL)	2,003	1,927	1,847	1,762	1,672	1,576
Expected change in OLTL	(76)	(80)	(85)	(90)	(96)	(101)
Debt at 31 March	**225,844**	**225,920**	**234,539**	**273,196**	**283,833**	**281,732**
Capital Financing Requirement (CFR)	**235,976**	**233,899**	**246,759**	**294,730**	**310,006**	**307,183**
Under / (over) borrowing	**10,132**	**8,135**	**12,220**	**21,534**	**26,173**	**25,451**

The debt is increasing due to presumed borrowing for building properites within the HRA and GF, it makes no assumptions about selling any of the properties built or any special purpose vehicle usage for the building of the properties.

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

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

Prospects for interest rates

20. The council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the council to formulate a view on interest rates. The following table gives the Capita Asset Services central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2015	0.50	2.20	3.40	3.40
Jun 2015	0.50	2.20	3.50	3.50
Sep 2015	0.50	2.30	3.70	3.70
Dec 2015	0.75	2.50	3.80	3.80
Mar 2016	0.75	2.60	4.00	4.00
Jun 2016	1.00	2.80	4.20	4.20
Sep 2016	1.00	2.90	4.30	4.30
Dec 2016	1.25	3.00	4.40	4.40
Mar 2017	1.25	3.20	4.50	4.50
Jun 2017	1.50	3.30	4.60	4.60
Sep 2017	1.75	3.40	4.70	4.70
Dec 2017	1.75	3.50	4.70	4.70
Mar 2018	2.00	3.60	4.80	4.80

Further detailed interest rate forecasts are given in Appendix 1.

21. UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided somewhat but still remains strong by UK standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 1.0% in November, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer

disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.

22. The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3. This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by mid 2015.

23. The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Greece: the general election on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strenthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify;

- As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could 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 2015/16 and beyond;

- Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. 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 higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

- 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.

Borrowing strategy

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

25. Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Chief finance officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

    - *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
    - *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

    Any decisions will be reported to Cabinet at the next available opportunity.

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

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

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

    The reasons for any rescheduling to take place may include:

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

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

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

28. **Municipal Bond Agency**
It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

Treasury indicators: limits on borrowing activity and affordability

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

Operational boundary £000	**2013/14 Actual**	**2014/15 Forecast**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
Debt	223,917	223,917	232,777	271,524	282,257	280,257
Other Long term Liabilities	1,927	1,847	1,762	1,672	1,576	1,475
Total	**225,844**	**225,764**	**234,539**	**273,196**	**283,833**	**281,732**

The debt is increasing due to presumed borrowing for building properties within the HRA and GF, it makes no assumptions about selling any of the properties built or any special purpose vehicle usage for the building of the properties.

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

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

Authorised Limit £000	**2013/14 Actual**	**2014/15 Forecast**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
Debt	263,917	263,917	272,777	311,524	322,257	340,257
Other Long term Liabilities	1,927	1,847	1,762	1,672	1,576	1,475
Total	**265,844**	**265,764**	**274,539**	**313,196**	**323,833**	**341,732**

The debt is increasing due to presumed borrowing for building properties within the HRA and GF, it makes no assumptions about selling any of the properties built or any special purpose vehicle usage for the building of the properties.

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

HRA debt limit £000	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
HRA Debt Cap	236,989	236,989	239,201	243,834	243,834	243,834
HRA CFR	209,052	207,992	209,219	233,893	240,059	239,466
HRA Headroom	27,937	28,998	29,982	9,941	3,775	4,368

Any slippage from 2014/15 to 2015/16 of the capital programme has not been reflected in the CFR for 2015/16 or any subsequent years, inclusion would reduce the headroom.

Treasury management limits on activity

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

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

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

£m	2014/15	2015/16	2016/17
Interest rate exposures			
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	20%	20%	20%

Limits on fixed interest rates: • *Debt only* • *Investments only*	100% 100%	100% 100%	100% 100%
Limits on variable interest rates • Debt only • Investments only	20% 20%	20% 20%	20% 20%
Maturity structure of fixed interest rate borrowing			
		Lower	**Upper**
Under 12 months		0%	10%
12 months to 2 years		0%	10%
2 years to 5 years		0%	30%
5 years to 10 years		0%	50%
10 years and above		0%	95%

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

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

%	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Non-HRA	7.63	5.16	6.52	8.60	9.64	10.00
HRA	12.02	12.07	11.74	11.68	11.05	10.73

The estimates of financing costs include current commitments and the proposals in this budget report, which are increasing due increased borrowing to fund building of properties. As stated above The debt is increasing due to presumed borrowing for building properties within the HRA and GF, it makes no assumptions about selling any of the properties built or of any special purpose vehicle usage for the building of the properties.

- **Incremental impact of capital investment decisions on council tax:** This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the 2015/16 budget report compared to the council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

- **Incremental impact of capital investment decisions on the band D council tax:** The impact of capital expenditure on the council tax would be derived from the effect of Revenue Contributions to Capital on the Council Tax Requirement. Since the council does not budget for any significant revenue contributions, the impact on the Council Tax Requirement, and therefore council tax, is nil.

- **Estimates of the incremental impact of capital investment decisions on housing rent levels:** Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in the 2015/16 budget report compared to the council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

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

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

<u>Investments</u>

Annual investment strategy

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

Year-end resources £000	2013/14 Actual	2014/15 Forecast	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Fund balances / reserves	33,443	25,935	10,876	11,022	9,578	8,580
Capital receipts	15,227	18,857	18,857	18,857	18,857	18,857
Other	6,772	9,248	9,288	7,988	6,502	5,241

Working capital*	45,464	25,500	25,500	25,500	25,500	25,500
Expected investments	**66,289**	**60,000**	**73,449**	**64,341**	**57,900**	**57,900**

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

A proportion of the capital receipts are ringfenced so can only be spent on specific capital works. It has been assumed that any capital receipts arising in a year are used to finance the capital programme in that year.

34. **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 Capita Asset Services (formerly Sector)al Guidance Notes ("the CIPFA TM Code"). The council's investment priorities will be security first, liquidity second, then return.

35. In accordance with the above guidance from the Welsh Government and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

36. Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

37. 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.

38. 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.

39. 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.

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

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

42. **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.

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

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

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

- Banks 1 - good credit quality **–** the council will only use banks which:
  - are UK banks; and/or
  - are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA
  - and have, as a minimum, the following Fitch, Moody's and Standard Poors credit ratings (where rated):
- Short term - F1, P1, A1
- Long term – A, A2, A
- Viability / financial strength – bbb+ (Fitch / Moody's only)
- Support – 5(Fitch only)

- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation - The council will use these only where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies The council will *use* all societies which:
    - meet the ratings for banks outlined above
    - have assets in excess of £2bn
    - or meet both criteria.
- Money market funds – *AAA*
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc
- Supranational institutions

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

- no more than 30% will be placed with any non-UK country at any time
- limits in place above will apply to a group of companies
- sector limits will be monitored regularly for appropriateness

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

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

	Fitch long term rating (or equivalent)	**Money Limit**	**Time Limit**
Banks 1 category high quality	*AA*	£15m	364 days
Banks 1 category lower quality	*A*	£10m	364 days
Banks 2 category – part	N/A	£15m	3yr

nationalised			
Limit 3 category – council's banker (not meeting Banks 1)	A-	£5m	3 months
Building Societies	Asset worth £2bn	£10m	364 days
DMADF	AAA	unlimited	6 months
Local authorities	N/A	£10m per LA	5 years
Money market Funds	AAA	£5m per fund	liquid
		£25m overall limit	

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

Investment strategy

50. **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).

51. **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2015/16 0.75%
- 2016/17 1.25%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth weakens for longer than expected. However, should the pace of growth quicken, there could be upside risk.

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:

- 2015/16 0.60%
- 2016/17 1.25%
- 2017/18 1.75%
- 2018/19 2.25%
- 2019/20 2.75%
- 2020/21 3.00%
- 2021/22 3.25%
- 2022/23 3.25%

Later years 3.5%

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

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

Maximum Principle Funds invested >364 days			
£m	**2015/16**	**2016/17**	**2017/18**
Principal sums invested > 364 days	£15m	£15m	£15m

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

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

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

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

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

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

55. **Liquidity** – in respect of this area the council seeks to maintain:

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

56. **Yield -** local measures of yield benchmarks are

- Investments – internal returns above the 7 day LIBID rate

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

Other

Training

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

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

Treasury Management Consultants

60. The council uses Capita Asset Services as its external treasury management advisors.

61. 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.

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

Integrated impact assessment	NORWICH City Council

The IIA should assess **the impact of the recommendation** being made by the report
Detailed guidance to help with completing the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	council
Committee date:	04 February 2015
Head of service:	Justine Hartley
Report subject:	Treasury Management Strategy 2015/16
Date assessed:	
Description:	

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

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

Recommendations from impact assessment
Positive
Negative
Neutral
Issues

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

Capita Asset Services Interest Rate View													
	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.10%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	0.70%	0.80%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.30%
12 Month LIBID	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yr PWLB Rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB Rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
Capital Economics	2.20%	2.50%	2.70%	3.00%	3.10%	3.20%	3.30%	3.40%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
Capital Economics	2.80%	3.05%	3.30%	3.55%	3.60%	3.65%	3.70%	3.80%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.25%	3.45%	3.65%	3.85%	3.95%	4.05%	4.15%	4.25%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.30%	3.50%	3.70%	3.90%	4.00%	4.10%	4.20%	4.30%	-	-	-	-	-

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

Economic Background

UK. After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014; the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

Eurozone (EZ). The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November 2014, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. It now appears likely that the ECB will embark on full quantitative easing (purchase of EZ country sovereign debt) in early 2015.

Concern in financial markets for the Eurozone subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout 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 (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some 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 likely to continue 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: the general election due to take place on 25 January 2015 is likely to bring a political party to power which is anti EU and anti-austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti-austerity political parties throughout the EU is much more difficult to quantify. 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 which have high unemployment rates. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti-austerity policies. Any loss of market confidence in either of the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

USA. The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently forecast that the first increase in the Fed. rate will occur by the middle of 2015.

China. Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for many years. There are also concerns that the Chinese leadership has only started to address an unbalanced economy which is heavily over 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 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. Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession in Q2 and Q3. The Japanese government already has the highest debt to GDP ratio in the world.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data transpires over 2015. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

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

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current 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. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur 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 weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an 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, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp 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 larger 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 to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK strong economic growth is weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.

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

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government
- ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.
- The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of

holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.

- A surge in investor confidence that a return to robust world economic growth is imminent, causing a flow of funds out of bonds into equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

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

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

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

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

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

The investment policy proposed for the council is:

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

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

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

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

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

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

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

	ratings. The council may use such building societies which have a minimum asset size of £2bn but will restrict these type of investments to	
e.	Any **bank or building society** that has a minimum long term credit rating of A+/A,, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	Maximum Limit of 100%, so long as no more than 25% of investments have maturities of longer the one year at any one time.
f.	Any **non rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to having a minimum asset size of £250m and a restriction on the investment amount to 1% of its assets size.	£10m for a maximum of 3 months
g.	**Certifcates of Deposit** or corporate bonds with banks and building societies	£5m
h.	Money market funds	£5m
i.	**Pooled property funds** – The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. The key exception to this is an investment in the CCLA Local Authorities Property Fund.	CCLA £5m

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

The treasury management role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.