

CHERWELL DISTRICT COUNCIL

Treasury Management Strategy

Minimum Revenue Provision Policy Statement and
Annual Investment Statement

2015-16

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 policies, estimates and actuals.

Report 1 - Treasury Strategy including Prudential and Treasury Indicators (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).

Report 2 - A Mid Year Treasury Management Report (if applicable) – 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. However, the Accounts Audit and Risk Committee will receive quarterly update reports.

Report 3 - An Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Accounts Audit and Risk Committee.

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1.3 Treasury Management Strategy for 2015-16

The strategy for 2015-16 covers two main areas:

Treasury management Issues

- the current treasury position;
- treasury indicators which will 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.

Capital Issues

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

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

1.4 Training

CIPFA's Code of Practice requires the responsible officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receives appropriate training relevant to their needs and fully understands their roles and responsibilities.

The Council's approach is:

- To identify Members who require training;
- To assess the level of training required and procure training from an external organisation with expertise in this area, including the Council's Treasury Advisor, Capita Asset Services; and
- To monitor the ongoing training needs of Members based on legislative, regulatory and best-practice requirements.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury Management Consultants

The Council uses Capita Asset Services, Treasury Solutions as its external treasury management advisors.

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

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

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2. Capital Prudential Indicators 2015/16 – 2017/18

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. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £'000	2013/14 Actual	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total	7,451	35,285	26,834	1,500	TBC

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

Capital expenditure £'000	2013/14 Actual	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total	7,451	35,285	26,834	1,500	TBC
Financed by:					
Capital receipts	(6,585)	(24,384)	(467)	(725)	(TBC)
Capital grants	(539)	(375)	(0)	(375)	(TBC)
Reserves funded through Revenue	(327)	(389)	(0)	(400)	(TBC)
Donated asset Contribution	(0)	(0)	(0)	(0)	(TBC)
External Funding	(0)	(900)	(0)	(0)	(TBC)
Net financing need for the year	0	9,237	26,367	0	TBC

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 £TBCm of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£'000	2013/14 Actual	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Capital Financing Requirement					
Total CFR	-3,152	6,085	32,452	32,452	TBC
Movement in CFR	0	9,237	26,367	0	TBC

Movement in CFR represented by					
Net financing need for the year (above)	0	9,237	26,637	0	TBC
Less MRP/VRP and other financing movements	0	0	0	0	TBC
Movement in CFR	0	9,237	26,637	0	TBC

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.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be either:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);
- **Depreciation method** – MRP will follow standard depreciation accounting procedures (option 4);

These options provide for a reduction in the borrowing need over approximately the asset's life.

Repayments included in annual PFI or finance leases are applied as MRP.

The Council has established a company to which it is providing loans on a commercial basis. The cash advances will be used by the company to fund capital expenditure and should therefore be treated as capital expenditure and a loan to a third party by the Council.

The Capital Financing Requirement (CFR) will increase by the amount of loans advanced and under the terms of contractual loan agreements are due to be returned in full by 2021, with interest paid under as per the contract.

Once funds are returned to the Council, the returned funds are classed as a capital receipt, off-set against the CFR, which will reduce accordingly. As this is a temporary (7 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 outstanding loan/CFR position will be reviewed on an annual basis and if the likelihood of default increases, a prudent MRP policy will commence.

To ensure that any required changes to this approach can be addressed promptly and prudently the Council has adopted a policy providing delegated authority to the Service Director of Resources to defer the charging of MRP in accordance with the Prudential Code and current accounting regulations in the following circumstances:

- There is a separately identifiable project with quantified borrowing costs.
- The period from the projects inception to it becoming operational is significantly in excess of 12 months.
- A business case has been produced incorporating the deferred MRP and capitalised interest which demonstrates that the project is prudent and affordable over its whole life.
- The borrowing and MRP amounts are material, in excess of £250,000 annually.
- The deferred MRP and accumulated interest will be charged to the appropriate revenue account on a prudent basis, once the project is operational.

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.).

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.

%	2013/14 Actual %	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %
Non-HRA	0	0	0	0	TBC

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

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3 Borrowing

3.1 The council is currently debt free however the capital programme as detailed in section 2 demonstrates that capital resources are diminishing. Future projects may require the need to borrow and for the council to enter into long term debt arrangements.

3.2 The Head of Finance and Procurement will monitor this situation and if and when there is a requirement to borrow outside of the operational and authorised limits as detailed below an updated version of this strategy will be prepared for member approval.

Treasury Indicators: limits to borrowing activity

3.3 **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	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	£15m	£40m	£40m	£40m
Other long term liabilities	£0	£0	£0	£0
Total	£15m	£40m	£40m	£40m

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 £'000	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Debt	£20m	£45m	£45m	£45m
Other long term liabilities	£0	£0	£0	£0
Total	£20m	£45m	£45m	£45m

4. Annual Investment Strategy

4.1 Changes to credit rating methodology

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and / or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.

It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

As a result of these rating agency changes, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that we have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, we will continue to utilise CDS prices as an overlay to ratings in our new methodology.

4.1 Investment Policy

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

In accordance with the above, 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 and watches published by all three ratings agencies with a full understanding of what the ratings reflect in the eyes of each agency.

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.

Using the Capita Asset Services ratings service banks' and building societies' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Further, Council 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. This is encapsulated within the credit methodology provided by the advisors, Capita Asset Services.

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 diversification 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 **Appendix 3** under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

4.2 Creditworthiness policy

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

- credit watches and credit outlooks from credit rating agencies;
 - CDS spreads to give early warning of likely changes in credit ratings;
 - sovereign ratings to select counterparties from only the most creditworthy countries.
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This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties.

These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

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

	Colour (and long term rating where applicable)	Money Limit	Time Limit
Banks *	yellow	£15m	5yrs
Banks	purple	£15m	2 yrs
Banks	orange	£15m	1 yr
Banks – part nationalised	blue	£15m	1 yr
Banks	red	£15m	6 mths
Banks	green	£15m	100 days
Banks	No colour	Not to be used	
DMADF	AAA	unlimited	6 months
Local authorities	n/a	£5m per auth	5 yrs
Money market funds	AAA	£10m per fund	liquid
Enhanced money market funds with a credit score of 1.25	Dark pink / AAA	£10m per fund	liquid
Enhanced money market funds with a credit score of 1.5	Light pink / AAA	£10m per fund	liquid

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

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1.

There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

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

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

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 supporting government.

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 . The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix 4**. 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 2015. Bank Rate forecasts for financial year ends (March) are:

- 2014-15 0.50%
- 2015/16 1.00%
- 2016/17 1.50%
- 2017/18 2.50%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an 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:

2014-15	0.50%
2015/16	1.00%
2016/17	2.10%
2017/18	2.60%

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

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

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

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

4.4 Icelandic Bank Investments –The council has received repayment of £5.7m of the initial Capital Investment of £6.5m with the remaining capital balance of £730,000 currently remaining in Iceland. The interest element attributed to the investment made - £624,000 also currently resides in Iceland.

The Council continues to pursue this with the LGA and Bevan Brittan for the transfer of these funds to the UK. It is too early to provide a definitive policy on how any exchange rate risk will be managed, but the expectation will be that the risk will be managed proactively and assets converted to sterling at the earliest opportunity.

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.

Appendix

1. Interest rate forecasts
2. Economic background
3. Treasury Management practice - Specified and non specified investments and limits
4. Approved countries for investments
5. Treasury management scheme of delegation and the role of the section 151 officer
6. Glossary

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Appendix 1: Interest Rate Forecasts 2014-2018

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														
	Dec-14	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%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.25%	2.50%
3 Month LIBID	0.50%	0.60%	0.80%	0.90%	1.10%	1.30%	1.40%	1.60%	1.90%	2.10%	2.10%	2.30%	2.40%	2.60%
6 Month LIBID	0.70%	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.80%
12 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.70%	1.80%	2.10%	2.20%	2.30%	2.40%	2.60%	2.80%	3.00%
5yr PWLB Rate	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%	3.50%	3.50%
10yr PWLB Rate	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.20%	4.30%	4.30%
25yr PWLB Rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
50yr PWLB Rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
Bank Rate														
Capita Asset Services	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.25%	2.25%	2.50%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	-	-	-	-	-
5yr PWLB Rate														
Capita Asset Services	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
Capital Economics	2.60%	3.00%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	-	-	-	-	-
10yr PWLB Rate														
Capita Asset Services	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.40%	4.40%	4.40%
Capital Economics	3.30%	3.50%	3.70%	3.85%	4.05%	4.15%	4.20%	4.25%	4.30%	-	-	-	-	-
25yr PWLB Rate														
Capita Asset Services	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	5.00%	5.00%	5.00%
Capital Economics	3.85%	4.05%	4.15%	4.25%	4.35%	4.40%	4.50%	4.55%	4.60%	-	-	-	-	-
50yr PWLB Rate														
Capita Asset Services	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	5.00%	5.00%	5.00%
Capital Economics	3.90%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	-	-	-	-	-

Appendix 2: Economic Background

UK. Strong UK GDP quarterly **growth** of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1, 0.9% in Q2 and a first estimate of 0.7% in Q3 2014 (annual rate 3.1% in Q3), means that the UK will have the strongest rate of growth of any G7 country in 2014. It also appears very likely that strong growth will continue through the second half of 2014 and into 2015 as forward surveys for the services and construction sectors are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though recent figures indicate a weakening in the future trend rate of growth. However, 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 through the initial threshold of 7%, set by the **Monetary Policy Committee (MPC)** last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back 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. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates 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) during 2014 after being consistently above the MPC's 2% target between December 2009 and December 2013. Inflation fell to 1.2% in September, a five year low. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1% and then to remain near to, or under, the 2% target level over the MPC's two year ahead time horizon. Overall, markets are expecting that the MPC will be cautious in raising **Bank Rate** as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The return to strong growth has also helped lower forecasts for the increase in **Government debt** by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

The Eurozone (EZ). The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, 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 to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt).

Concern in financial markets for the Eurozone subsided considerably during 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 remains particularly vulnerable but has made good progress in reducing its annual budget deficit and in returning, at last, to marginal economic growth. Whilst a Greek exit from the Euro is now improbable in the short term, some commentators still view the inevitable end game as either being another major right off of debt or an eventual exit.

There are also 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 24% and unemployment among younger people of over 50 – 60%. 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. Any loss of market confidence in the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

USA. The Federal Reserve started to reduce its monthly asset purchases of \$85bn in December 2013 by \$10bn per month; these ended in October 2014, signalling confidence the US economic recovery would remain on track. First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in Q2 to 4.6% (annualised). The first estimate of Q3 showed growth of 3.5% (annualised). Annual growth during 2014 is likely to be just over 2%.

The U.S. faces similar debt problems to those of 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, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions. It is currently expected that the Fed. will start increasing rates in mid 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 been mixed. There are also concerns that the Chinese leadership have only started to address 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 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. In Q2 growth was -1.8% q/q and -7.1% over the previous year. The Government is hoping that this is a temporary blip.

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, 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. Over time, an increase in investor confidence in world economic recovery is also likely to compound this effect as recovery will further encourage investors to switch 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 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 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:

- The situation over Ukraine poses a major threat to EZ and world growth if it was to deteriorate into economic warfare between the West and Russia where Russia resorted to using its control over gas supplies to Europe.
 - Fears generated by the potential impact of Ebola around the world
 - UK strong economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014.
 - A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth beyond 2014.
 - Weak growth or recession in the UK's main trading partner - the EU, inhibiting economic recovery in the UK.
 - 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.
 - Recapitalisation of European banks requiring considerable government financial support.
 - Lack of support by populaces in Eurozone countries for 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.
 - Italy: the political situation has improved but it remains to be seen whether the new government is able to deliver the austerity programme required and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.
 - France: after being elected on an anti austerity platform, President Hollande has embraced a €50bn programme of public sector cuts over the next three years. However, there could be major obstacles in implementing this programme. Major overdue reforms of employment practices and an increase in competitiveness are also urgently required to lift the economy out of stagnation.
 - Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
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- Heightened political risks in the Middle East and East Asia could trigger safe haven flows back into bonds.
- There are also increasing concerns at the reluctance of western central banks to raise interest rates significantly for some years, plus the huge QE measures which remain in place (and may be added to by the ECB in the near future). This has created potentially unstable flows of liquidity searching for yield and, therefore, heightened the potential for an increase in risks in order to get higher returns. This is a return to a similar environment to the one which led to the 2008 financial crisis.

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

- A further surge in investor confidence that robust world economic growth is firmly expected, 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.

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Appendix 3: Treasury Management Practice (TMP1) - Credit and Counterparty Risk Management

SPECIFIED INVESTMENTS:

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies	Green	In-house
Term deposits – banks and building societies	Short-term F1, Long-term A, Viability BB+	Fund Manager

Term deposits with nationalised banks and banks and building societies

	Minimum Credit Criteria	Use	Max £	Max. maturity period
UK part nationalised banks	Green	In-house	£15m including Investec's limit	364 days
UK part nationalised banks	UK sovereign rating or Short-term F1, Long term A ,Viability BB+	Fund Manager	Max 15% of fund	364 days

Collateralised deposit	UK sovereign rating	In-house and Fund Managers
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	Green	In-house and Fund Manager
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	Short-term F1, Long-term A, Viability BB+	Fund Manager
UK Government Gilts	UK sovereign rating	In house buy and hold and Fund Manager
Bonds issued by multilateral development banks	AA-	In house buy and hold and Fund Manager
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	In house buy and hold and Fund Manager

Sovereign bond issues (other than the UK govt)	AA-	In house buy and hold and Fund Manager
Treasury Bills	UK sovereign rating	In house and Fund Manager
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Government Liquidity Funds	AAA	In-house
2. Money Market Funds	AAA	In-house
3. Enhanced Money Market Funds with a credit score of 1.25	AAA	In-house
4. Enhanced Money Market Funds with a credit score of 1.5	AAA	In-house

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: A maximum of 30% will be held in aggregate in non-specified investment

. Maturities of ANY period

	* Minimum Credit Criteria	Use	Max % of fund	Max. maturity period
Commercial paper issuance covered by a specific UK Government (explicit) guarantee	Short-term F1, Long-term A, Viability BB+	In- house and Fund Manager	15%	2 years
Commercial paper other	Short-term F1, Long-term A, Viability BB+	In- house and Fund Manager	15%	2 years
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	Short-term F1, Long-term A, Viability BB+	In- house and Fund Manager	15%	2 years
Investment in Share Capital of a wholly owned and /or subsidiary company of the Council	Not applicable	In- house	Not applicable	Not applicable

Appendix 4: Approved countries for investments

Based on lowest available rating

AAA

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

AA+

- Finland
- Hong Kong
- Netherlands
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar

AA-

- Belgium
 - Saudi Arabia
-

Appendix 5: Treasury management scheme of delegation

6.1 Full council

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

6.2 Executive

- 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.

6.3 Accounts Audit & Risk Committee

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

6.4 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.
-

Appendix 6: Glossary

Asset Class Limits	Limit on the amount of the total portfolio that can be invested an asset class for example credit rated Banks, Money Market Funds unrated Building Societies
Asset Life	The length of the useful life of an asset e.g. a school
Borrowing / Investment Portfolio	A list of loans or investments held by the Council.
Borrowing Requirement	The amount that the Council needs to borrow to finance capital expenditure and manage debt.
Callable deposit	Funds placed with a financial institution without a fixed maturity date (i.e. the money can be 'called' or withdrawn at any time).
Capitalisation direction	Government approval to use capital resources to fund revenue expenditure.
Cash deposits	Funds placed with a financial institution with a fixed maturity date and interest rate.
Certificates of deposits	(CD). CDs evidence fixed maturity time deposits with issuing banks or other deposit-taking institutions. Maturities range from less than a week to five years. They are normally negotiable and enjoy a liquid secondary market. They state the (1) amount deposited, (2) rate of interest, and (3) minimum period for which the deposit should be maintained without incurring early withdrawal penalties.
CIPFA Code of Practice on Treasury Management	A code of practice issued by CIPFA detailing best practice for managing the treasury management function.
Collateralised Deposit	Term deposits with UK institutions where such deposits are secured against a collateral pool comprised of loans made to UK local authorities.
Counterparty	Banks, Building Societies and other financial institutions that the Council transacts with for borrowing and lending.
Credit Arrangements	Methods of financing such as the use of finance leases
Credit Ratings	A scoring system used by credit rating agencies such as Fitch, Moody's and Standard and Poors to indicate the creditworthiness and other factors of a Governments, banks, building societies and other financial institutions.
Creditworthiness	How highly rated an institution is according to its credit rating.
Debt Management Office	An agency of the HM Treasury and its responsibilities include debt and cash management for the UK

	Government
Debt Rescheduling	Refinancing loans on different terms and rates to the original loan.
Financial instrument	Document (such as a bond, share, bill of exchange, futures or options contract) that has a monetary value or evidences a legally enforceable (binding) agreement between two or more parties regarding a right to payment of money.
Fitch Ratings	A credit rating agency.
Forward commitment	Written agreement by a lender to advance a loan on a future date at a specified interest rate. It automatically expires if not exercised by the potential borrower.
Gilts	Also known as Gilt-edged Securities. UK central Government debt. It may be dated (redeemable) or undated. Undated gilts are perpetual debt, paying a fixed periodic coupon but having no final redemption date. Gilt yields are conventionally quoted in the UK markets on a semi-annual basis.
Interest Rate exposures	A measure of the proportion of money invested and what impact movements in the financial markets would have on them.
Lender Option Borrower Option (LOBO)	Loans that have a fixed rate for a specified number of years then can be varied by the lender at agreed intervals for the remaining life of the loan.
Limits for external debt	A Prudential Indicator prescribed by the Prudential Code sets limits on the total amount of debt the Council could afford.
Liquidity	Access to cash that is readily available.
Lowest Common Denominator	Whereby rating agencies provide credit ratings of institutions and the lowest rating is applied to determine whether they meet the criteria to be on the Council's lending list.
Maturity	The date when an investment is repaid or the period covered by a fixed term investment.
Maturity Structure of Borrowings	A profile of the Council's loan portfolio in order of the date in which they expire and require repayment.
Minimum Revenue Provision	The minimum amount, which must be charged to an authority's revenue account each year for the prudent repayment of debt.
Money Market Funds	Open ended collective investment fund that invests in highly-liquid short-term financial instruments (with maturities typically 90 days to less than one year).
Moody's	A credit rating agency.
Non Specified Investments	Investments deemed to have a greater potential of

	risk, such as investments for longer than one year or with institutions that do not have credit ratings, like some Building Societies. Limits must be set on the amounts that may be held in such investments at any one time during
Portfolio	A number of different assets, liabilities, or assets and liabilities together, considered as a whole. For example, a diversified investment portfolio. An investor in such a portfolio might hold a number of different investment assets within the portfolio, with the objectives of growing the total value of the portfolio and limiting the risk of losses.
Prudential Borrowing	Borrowing undertaken by the Council that does not attract government support to help meet financing costs.
Prudential Code for Capital Finance in Local Authorities	The capital finance system is based on the Prudential Code developed by CIPFA. The key feature of the system is that local authorities should determine the level of their capital investment and how much they borrow to finance that investment based on their own assessment of what they can afford.
Prudential Indicators	The key objectives of the Prudential Code are to ensure that the capital investment plans are affordable, sustainable and prudent. As part of this framework, the Prudential Code sets out several indicators that must be used to demonstrate this.
Public Works Loan Board (PWLB)	A central government agency which provides loans to local authorities and other prescribed institutions at interest rates slightly higher than those at which the Government itself can borrow.
Credit Rated	Institutions that possess a credit rating from a credit rating agency such as Fitch, Moody's or Standard and Poors.
Risk Control	Putting in place processes to control exposures to events.
Security	Placing cash in highly rated institutions.
Sovereign debt rating	Assessment of the international rating agencies of the likelihood that a particular country will default on its loans.
Specified Investments	Investments that offer high security and liquidity. They must have a maturity of no longer than 364 days.
Standard and Poors	A credit rating agency.
Supranational Institutions	Multi national structures - an amalgamation of different countries offering investment opportunities - for example Euro Investment Bank
UK Government Investments	Debt Management Office (DMO) deposits and bonds (gilts) for which maturity date at time of purchase is less than 365 days away

Yield	The rate of return on the current market value of an asset or liability, usually expressed as a percentage per annum. For example, today's yield to maturity of a bond measures the total return to an investor in the bond, reflecting both the interest income over the life of the bond and any capital gain (or loss) from today's market value to the redemption amount payable at maturity.
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