APPENDIX 2

Annual Treasury Management and Investment Strategy Statements 2013/14

1. Introduction

Treasury Management Policy Statement

1.1 The Council defines its treasury management activities as: "The management of the 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 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.

1.3 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.

Statutory requirements

1.4 The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential Indicators for the next 3 years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

1.5 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act); this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.6 The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice.

Chartered Institute of Public Finance and Accountancy (CIPFA) requirements

1.7 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management was adopted by this Council on 21 March 2002, and the November 2009 revised Code was adopted on 23 February 2010. A further revision to the code was issued in November 2011, which included requirements for public sector organisations who have powers to invest in derivatives and Housing Authorities affected by the move to self financing. These changes do not directly impact upon this Council.

1.8 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an Annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Treasury Management Sub-Committee.

Treasury Management Strategy for 2013/14

1.9 The strategy for 2013/14 covers the following:

- Statutory requirement for a balanced budget
- treasury limits in force which will limit the treasury risk and activities of the Council
- prudential indicators
- the current treasury position
- prospects for interest rates
- the borrowing strategy
- the investment strategy
- creditworthiness policy and lending criteria
- policy on use of external providers
- the treasury management scheme of delegation
- the Council's Minimum Revenue Provision (MRP) strategy.

Balanced Budget Requirement

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

- increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- any increases in running costs from new capital projects

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2. Treasury Limits for 2013/14 to 2015/16

2.1 It is a statutory duty under S.3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

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

2.3 The Council is debt free and there are no plans to borrow monies in the foreseeable future. Within this overall strategy the Head of Resources and Performance may approve short term borrowings (ie less than 12 months in duration) to provide for day to day cash flow management requirements. This does not affect the Council's debt free strategy or status.

3. Prudential and Treasury Indicators for 2013/14 to 2015/16

3.1 The Prudential Code requires the Council to set Prudential Indicators on External Debt. As indicated above it is not anticipated that the Council will undertake any borrowing during this year other than to cover short term cash flow management requirements. As a result the "Authorised Limit" has been set at £5m (to cover potential short term cash flow requirement) and the "Maturity Structure of Borrowing" has been set at zero (ie we are to retain our debt free position).

3.2 The Council must also consider risk associated with interest rate exposures and set upper limits on the level of investments for both fixed rate and variable rate investments, together with an upper limit on the level of investments with maturity of more than 364 days. The majority of in-house investments are fixed rate. To provide maximum flexibility it is proposed that the upper limit on fixed rate investments be set at 95% of the amount available for investment. Similarly in order to provide maximum flexibility, the upper limit on variable rate investments has been set at 60% of total investments, so that at all times the Council has at least 40% in fixed rate investments to provide stability.

3.3 With regard to sums invested for more than 364 days, there is a need to balance certainty of income with flexibility to take advantage of upward movements in interest rates, whilst at the same time retaining a core element of investments that can be easily liquidated should the need arise. The upper limit on investments for more than 364 days has therefore been set at £20 million. This figure allows the in-house treasury management team to invest up to £20 million for periods of 1 to 5 years to provide increased certainty of income.

3.4 As a result the following prudential and treasury management indicators are relevant for the purposes of setting an integrated treasury management strategy.

	2012/13	2012/13	2013/14	2014/15	2015/16
TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
	actual	**probable outturn**	**estimate**	**estimate**	**estimate**
Authorised limit for external debt -					
Borrowing	£0.00	£0.00	£5,000.00	£5,000.00	£5,000.00
other long term liabilities	£0.00	£0.00	£0.00	£0.00	£0.00
TOTAL	£0.00	£0.00	£5,000.00	£5,000.00	£5,000.00
Operational boundary for external debt -					
Borrowing	£0.00	£0.00	£0.00	£0.00	£0.00
other long term liabilities	£0.00	£0.00	£0.00	£0.00	£0.00
TOTAL	£0.00	£0.00	£0.00	£0.00	£0.00
Upper limit for fixed interest rate exposure					
expressed as a % of total investments			95%	95%	95%
	2012/13	**2012/13**	**2013/14**	**2014/15**	**2015/16**
Upper limit for variable rate exposure					
expressed as a % of total investments			60%	60%	60%
Upper limit for total principal sums invested for over 364 days (per maturity date)			£20m	£20m	£20m

4. Annual Investment Strategy

Investment Policy

4.1 The Council will have regard to the Department for Communities and Local Government's (CLG) Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2011 revised CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

4.2 The Council's investment priorities are the security of capital and the liquidity of its investments. The Council will also aim to achieve the optimum return on investments commensurate with proper levels of security and liquidity.

4.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

4.4 Investment instruments identified for use in the financial year are set out in section 5 below.

5. Creditworthiness Policy and Lending Criteria

Rated Banks and Building Societies

5.1 This Council uses the creditworthiness service provided by Sector Treasury Services Ltd. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:-

- credit watches and credit outlooks from credit rating agencies
- sovereign ratings to select counterparties from only the most creditworthy countries
- credit default swap (CDS) data

5.2 This modelling approach combines credit ratings, credit watches, credit outlooks and credit default swaps in a weighted scoring system for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the creditworthiness of counterparties and the maximum duration and value of investments with individual banks and building societies. Where banks/building societies are part of a merged group structure, the limits are applied to the group as a whole. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in-house resources.

5.3 Sector produces two colour codes for each counterparty. The first colour code is based upon the assessments of the credit rating agencies and takes account of rating watches and outlooks as well as changes in sovereign ratings. The second colour code also takes account of Credit Default Swap (CDS) data relating to individual counterparties, which can give an early warning of potential changes in credit ratings. The Council uses the first colour code to determine the maximum value and duration of investments, but remains mindful and takes into account CDS data provided by Sector (particularly where CDS spread is shown as "out of range" within the Sector model), together with other market data, and can be selective in the names of the counterparties used. Within this framework the Council will therefore use counterparties within the following colour coded bands:

Lending Criteria: Rated Banks and Investment Scheme

Sector Colour Code Key	Maximum Duration / Investment Values*
Purple	Max £10m for max of 2 years (subject to max 50% of portfolio)
Orange	£9m for max of 2 years (subject to max 40% of portfolio)
Red	£8m for max of 1 year (subject to max 35% of portfolio)
Green	£6m for max of 6 months (subject to max 30% of portfolio)
Blue (nationalised / substantially owned by the UK government)	£15m for max of 2 years

** Note – This represents an adaption of the Sector approach*

5.4 The lending criteria for rated building societies is based on the same Sector colour coding system as the rated banks.

Lending Criteria – Rated Building Societies

Sector Colour Code Key	Proposed Limits*
Red	£8m for max of 1 year (subject to max 35% of portfolio)
Green	£6m for max of 1 year (subject to max 30% of portfolio)

- *Note – This represents an adaption of the Sector approach*

5.5 All credit ratings will be monitored on an on-going basis. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

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

5.6 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information (as provided by the Council's brokers), information on government support for banks and the credit ratings of that government support.

Non Rated UK Building Societies

5.7 The majority of UK building societies do not obtain formal credit ratings and as such, investments with these organisation have to be treated with caution. In the absence of formal credit ratings Sector advises caution in the use of such counterparties, particularly in the current economic climate. The following credit criteria (based on asset values and other sources of financial and credit rating information) have been established by the Council in consultation with Sector and seek to limit the value and duration of investments with these organisations.

Non Rated UK Building Societies – Asset Base Criteria

Asset Base	Maximum Duration / Investment Values
Asset base > £2,500m	£3m for max 6 months
Asset base > £1,000m	£2.5m for max 6 months

5.8 In addition to the above asset base criteria the following additional criteria are applied:

- A commercial credit rating organisation, Dun and Bradstreet, to be used to provide credit rating reports on building societies, prior to the placing of funds, to ensure that the proposed investment values are within recommended credit limits
- Latest available accounts to be obtained and reviewed by in-house staff to establish key trends and to ensure that Dun and Bradstreet recommendations are based on latest available financial results
- Review of available media coverage for any advance negative warnings regarding the stability of individual building societies.

5.9 The Head of Resources and Performance, in consultation with the Portfolio Holder for Performance and Resources, will continue to monitor the adequacy of the above lending criteria and make changes as necessary to respond to the changing economic climate and external advice. Details of any changes made will be included within the next treasury management reporting cycle to the Performance and Audit Scrutiny Treasury Management Sub Committee, Cabinet and full Council.

Investment Instruments

5.10 Investment instruments identified for use in the financial year are listed below under the Specified and Non Specified investment categories.

5.11 **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
Debt Management Agency Deposit Facility	--
Treasury Bills	--
Term deposits – local authorities	--
Term deposits – banks and rated building societies (see separate table for credit criteria re non-rated building societies)	Based on Sector's Colour Code system
Bonds issued by a financial institution which is guaranteed by the UK government	AAA
Certificates of deposits issued by banks and building societies	Short-term F1, Long-term A, Individual C, Support 2
Sovereign bond issues (non-UK)	AAA
Money Market Funds	Short-term F1, Long-term A, Individual C, Support 2

5.12 **Non-Specified Investments -** All such investments will be sterling denominated, with maturities over 1 year, meeting the minimum 'high' rating criteria where applicable, or with non rated organisations – ie non rated building societies.

A maximum of 90% will be held in aggregate in non-specified investments

	Minimum Credit Criteria	**Max % of total investments**	**Max. maturity period**
Term deposits – other LAs with maturities >1yr	-	50	2 years
Term deposits – non-rated building societies	See table at 5.7 above	90	1 year
Term deposits – banks and rated building societies with maturities >1yr	Based on Sector's Colour Code system – see tables at 5.3 & 5.4 above	90	2 years
	Minimum Credit Criteria	**Max % of total investments**	**Max. maturity period**
Bonds issued by multilateral development banks with maturities >1yr	AAA	25	2 years
Bonds issued by a financial institution which is guaranteed by the UK government with maturities >1yr	AAA	25	2 years

Country limits

5.13 The Council has determined that it will only use approved counterparties from countries other than the UK with a minimum sovereign credit rating of AAA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide).

6. Investment Strategy

6.1 **Management of Council's Investments -** All the Council's investments are currently managed in house. The majority of the Council's investments are placed through the money markets with banks and building societies for fixed periods of time (up to two years duration) and at fixed rates of interest. The Council also retains a core balance within liquidity accounts which takes account of the Council's proposed capital expenditure and the need to retain flexibility for cash flow purposes. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short and long term interest rates.

6.2 **Bank Base Rate Projections** - The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2012	0.50	1.50	3.70	3.90
March 2013	0.50	1.50	3.80	4.00
June 2013	0.50	1.50	3.80	4.00
Sept 2013	0.50	1.60	3.80	4.00
Dec 2013	0.50	1.60	3.80	4.00
March 2014	0.50	1.70	3.90	4.10
June 2014	0.50	1.70	3.90	4.10
Sept 2014	0.50	1.80	4.00	4.20
Dec 2014	0.50	2.00	4.10	4.30
March 2015	0.75	2.20	4.30	4.50
June 2015	1.00	2.30	4.40	4.60
Sept 2015	1.25	2.50	4.60	4.80
Dec 2015	1.50	2.70	4.80	5.00
March 2016	1.75	2.90	5.00	5.20

6.3 Sector have advised that the economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the economy returned to positive growth in the third quarter of 2012. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income, general malaise about the economy and employment fears. Difficulties in the Eurozone together with further US fiscal tightenting are continuing to depress UK growth which in turn will impact on the UK deficit reduction plans.

6.4 This challenging and uncertain economic outlook has significant treasury management implications. The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods. In addition, investment returns are likely to remain relatively low during 2013/14 and beyond.

6.4 The Council will avoid locking into longer term deals while investment rates are at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by this Council.

6.5 **2013/14 Target Rate on Investments** - Sector are projecting that the bank of England's Monetary Policy Committee will hold base rates at their current historic low of 0.5% through to the final quarter of 2014/15. Based on this projection, and taking into account the returns being achieved on the Council's current portfolio of fixed term investments, the average target rate investment return for 2013/14 is 1.5%. Assuming increases in base rate in line with Sector projections (6.2 above), the projected rates of return on Council investments for the following 3 years are as follows:

- 2014/15 1.5%
- 2015/16 1.5%
- 2016/17 2.5%

6.6 Taking into account the projected value of the investment portfolio after cash flow movements during 2013/14, it is estimated that investments in 2013/14 will generate income of £0.554m.

7. Policy on the use of external service providers

7.1 The Council uses Sector Treasury Services Ltd (Sector) 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.

8. Treasury management scheme of delegation

8.1 The Council's scheme of delegation for the treasury management function is as follows:

(i) Cabinet/Full Council

- Adoption of revised CIPFA Treasury Management Code and Treasury Management Policy
- Approval of Annual Treasury Management and Investment Strategy (prior to start of financial year)
- Receiving/reviewing mid-year treasury management report
- Receiving/reviewing annual outturn report
- Budget consideration and approval

(ii) Performance and Audit Scrutiny Committee (Treasury Management Sub Committee)

- reviewing the treasury management policy and procedures and making recommendations to the Cabinet/Full Council

- reviewing quarterly treasury management performance reports, mid year review and annual outturn reports and making recommendations to Cabinet/full Council

(iii) The treasury management role of the Head of Resources and Performance

- recommending clauses and treasury management policy for approval, reviewing the same regularly, and monitoring compliance
- approval of treasury management practices (TMPs)
- 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 adequacy of division of duties
- ensuring the adequacy of internal audit, and liaising with external audit
- approving the appointment of external service providers
- approving changes to counterparty credit limits, in consultation with the Portfolio Holder for Performance and Resources

9. Minimum Revenue Provision Policy Statement

9.1 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. Capital expenditure can be financed though the Council's capital reserves (accumulated from capital receipts), revenue contributions (including use of revenue reserves) or external debt. Where capital expenditure is financed by external debt it would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred and such expenditure is spread over several years to match the expected useful life of the asset. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

9.2 Statutory Instrument 2008 no. 414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146, (as amended)

9.3 There is no requirement to charge MRP where the Council's Capital Financing Requirement (the underlying need for the Council to borrow) is nil or negative at the end of the preceding financial year. As the Council is currently debt free there is therefore no requirement to charge MRP. Should the Council's debt free status change the Council will implement the Minimum Revenue Provision (MRP) in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

St Edmundsbury
BOROUGH COUNCIL

D252

Treasury Management Sub-Committee
21 January 2013

Treasury Management Performance and Annual Treasury Management and Investment Strategy 2013/14

1. Summary and reasons for recommendations

1.1 CIPFA's revised Code of Practice for Treasury Management (the Code) published in November 2009, was adopted by the Council on 23 February 2010. Given that treasury management activities involve the management of significant cashflows and investments, the Code requires that members are provided with regular reports on the performance of the Council's treasury management function. In addition, prior to the start of each financial year, the Council is required to formally approve an Annual Treasury Management and Investment Strategy setting out its treasury management policies and strategies for the forthcoming year.

1.2 The purpose of this report is to:

a. provide an update on treasury management activity and performance for the period 1 April to 31 December 2012; and
b. seek approval for the Annual Treasury Management and Investment Strategy Statements for 2013/14 and Prudential Indicators.

2. Recommendations

3.1 The Sub-Committee is asked to:
a. scrutinise the content of this report, including details of treasury management performance for the first 9 months of the financial year, and
b. make recommendations via the Performance and Audit Scrutiny Committee to Cabinet and Council regarding approval of the proposed Annual Treasury Management and Investment Strategy for 2013/14 (appendix 2 refers).

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3. Corporate priorities

3.1 The recommendations meet the following corporate priorities, as contained within the Corporate Plan:

(a) Working together for prosperous and environmentally-responsible communities, and

(b) Working together for an efficient Council.

4. Key issues

4.1 Investment Activity: 1 April 2012 to 31 December 2013

4.1.1 The total amount invested at 1 April 2012 was £32.0m and at 31 December was £42.45m. The increase in balances over this period was due primarily to timing differences in respect of the collection of local taxes (Council Tax and Non Domestic Rates) and the payment of precepts (ie to Suffolk County Council, Suffolk Police and central government). The average level of funds available for investment purposes in the first 9 months of 2012/13 was £39.7m.

4.1.2 The 2012/13 Annual Treasury Management and Investment Strategy set out the Council's projections for the current financial year. The budget for investment income in 2012/13 is £0.569m representing a target rate of return on investments of 1.50%.

4.1.3 As at the end of December 2012 interest actually earned during the first 9 months of the financial year amounted to £0.499m against the profiled budget for the period of £0.440m, a budgetary surplus of £0.059m. This modest budgetary surplus was due to the achievement of a higher than projected average rate of interest during the period (i.e. an average rate of retuned of 1.67% against a target rate for the period of 1.5%) which in turn was due primarily to preferential rates of interest obtained on investments with the Bank of Scotland. In view of the range of fixed duration investments already in place it is expected that the 2012/13 budgeted investment income will be achieved despite significant recent falls in interest rates.

4.1.4 A full list of investments held as at 31 December 2012 is shown at Appendix 1.

4.1.5 Due to continuing concerns about the economic recession, the Council's treasury management advisors (Sector) are currently predicting that the Bank of England's Monetary Policy Committee (MPC) will hold bank base rates at their current historic low of 0.5% through to March 2015.

4.2 Annual Treasury Management and Investment Strategy 2013/14

4.2.1 The CIPFA Code of Practice requires that a treasury management and investment strategy is approved by the Council prior to the beginning of the financial year to which it relates. The proposed Treasury Management and Investment Strategy Statement for 2013/14, attached at Appendix 2 to this report, meets the requirements of the CIPFA code together with the DCLG's Guidance on Local Government Investments and the statutory requirements of the Local Government Act. The strategy gives priority to the security and liquidity of investments whilst at the same time seeking to achieve value for money in treasury management. It also seeks to give maximum flexibility in terms of the usage of fixed and variable rate investments and allows for the balancing of certainty of income arising from fixed term investments with the need to retain a core balance that can be easily liquidated should the need arise.

4.2.2 The strategy confirms the Council's debt free status and indicates that there are no plans to borrow monies for capital purposes in the foreseeable future. Within this overall strategy the Head of Resources and Performance may approve short term borrowings (less than 12 month in duration) to provide for day to day cash flow management. This does not affect the Council's debt free status.

4.2.3 It is estimated that in 2013/14 treasury management activity will generate income of £0.554m representing a target investment rate for the year of 1.5%. This estimate takes account of Sector's views on future interest rate levels as well as:

- revised projections for Council balances taking into account the updated and rescheduled capital expenditure and asset disposals programmes; and

- the maturity dates for the Council's current fixed term investments.

4.2.4 Appendix 3 provides a summary of the national and international interest rate forecasts provided by the Council's treasury management advisors (Sector) which support the underlying interest rate projections used in the preparation of these estimates.

5. Other options considered

5.1 Options for the management of Council investments are formally considered within the annual treasury management and investment strategy. This includes key strategies in respect of the maintenance of the Council's debt free status, the continuation of in-house management of funds, and the approach to be adopted in establishing the credit worthiness of potential counterparties. The changing nature of the economic climate requires that these key areas are subject to on-going review.

6. Community impact

6.1 None

7. Consultation

7.1 Treasury management activities are undertaken in consultation with Sector (the Council's appointed Treasury Management advisers) and also take into account information obtained from investment brokers and other economic commentators. This committee provides for the scrutiny of treasury management strategies and performance, with changes in strategies and policies subject to approval by Cabinet and full Council.

8. Financial and resource

8.1 Total budgeted income for 2012/13 from the investment of Council balances is £0.569m.

9. Risk / opportunity assessment *(potential hazards or opportunities affecting corporate, service or project objectives)*

Risk area	**Inherent level of risk** (before controls)	**Controls**	**Residual risk** (after controls)
	High/Medium/Low		High/Medium/Low
Fluctuations in interest rates or in projected cashflows having significant impact on budgeted investment income.	High	Spread of investments for periods of up to two years. Budget monitoring and quarterly performance reports. Use of interest equalisation reserve to smooth out year-on-year fluctuations.	Medium
Bank / building society failure resulting in loss of Council funds.	High	Use of Sector advice on counterparty credit ratings (based on Fitch and Moody ratings) and the setting of lending limits. Use of non-rated building societies based on asset base and additional credit checks.	Medium

10. Legal and policy implications

10.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2011/12. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

11. Wards affected

11.1 n/a

12. Background papers

12.1 Treasury Management Performance and Annual Treasury Management and Investment Strategy – 2012/13 (C294).

APPENDIX 1

Council Investments as at 31 December 2012

Principal	Counterparty	Start Date	Maturity Date	Interest Rate (%)
£2,000,000	Santander UK Business Reserve Account	Inst/Acc	Inst/Acc	0.6500
£250,000	Bank of Scotland Call A/C	Inst/Acc	Inst/Acc	0.7500
£5,500,000	Barclays Reserve Account	Inst/Acc	Inst/Acc	0.7000
£4,950,000	NatWest Call Account	Inst/Acc	Inst/Acc	0.8500
£6,000,000	NatWest 95 Day Notice Account	95 day	95 day	1.2000
£1,500,000	Nationwide Building Society	03/09/2012	15/01/2013	0.6500
£2,000,000	Bank of Scotland	14/12/2011	13/02/2013	3.1000
£2,500,000	Bank of Scotland	16/02/2012	13/02/2013	3.1000
£1,500,000	Nationwide Building Society	15/08/2012	15/02/2013	0.8300
£2,000,000	Nationwide Building Society	02/10/2012	15/03/2013	0.6800
£1,500,000	Bank of Scotland	01/05/2012	11/04/2013	3.0000
£2,000,000	Bank of Scotland	27/07/2012	04/07/2013	3.0000
£2,000,000	Bank of Scotland	31/07/2012	31/07/2013	2.8500
£3,000,000	NatWest	22/08/2012	21/08/2013	2.2500
£1,500,000	Bank of Scotland	26/10/2012	25/10/2013	2.2500
£1,000,000	Ulster Bank	19/11/2012	18/11/2013	1.6000
£1,500,000	Bank of Scotland	04/09/2012	04/09/2014	3.2000
£1,750,000	Bank of Scotland	01/11/2012	03/11/2014	2.1500
£42,450,000	**TOTAL**			

Appendix 3

Economic Background – National and International Forecasts

1. Introduction

1.1 This appendix provides a summary of the international and national economic forecasts (including details of comparative interest rates projections) provided by the Council's treasury management advisors, Sector Treasury Services Ltd (Sector). This information is provided in support of Sector's projections on interest rates which are used by the Council to help determine the annual target rate of investment return for 2013/14 and future years.

2. Sector's National and International Forecasts

The Global economy

2.1 The Eurozone debt crisis has continued to cast a pall over the world economy and has depressed growth in most countries. This has impacted the UK economy and is creating a major headwind for recovery in 2013. This recession is the worst and slowest recovery of any of the five recessions since 1930. A return to growth of 1% in quarter 3 of 2012 is unlikely to prove anything more than a washing out of the dip in the previous quarter before a return to weak, or even negative, growth in the final quarter of the year.

2.2 The **Eurozone sovereign debt crisis** has abated somewhat following the European Central Bank's (ECB) pledge to buy unlimited amounts of bonds of countries which ask for a bailout. The immediate target for this statement was Spain which continues to prevaricate on making such a request (for a national bailout) and so surrendering its national sovereignty to International Monetary Fund (IMF) supervision. However, the situation in Greece is heading towards a crunch point as the Eurozone imminently faces up to having to relax the time frame for Greece reducing its total debt level below 120% of Gross Domestic Product (GDP) and providing yet more financial support to enable it to do that. Many commentators still view a Greek exit from the Euro as inevitable as total debt now looks likely to reach 190% of GDP i.e. unsustainably high, unless the Eurozone were to accept a major write down of Greek debt. The possibility of a write down has now been raised by the German Chancellor, but not until 2014-15, and provided the Greek annual budget is in balance.

2.3 Sentiment in financial markets has improved considerably since this ECB action and recent Eurozone renewed commitment to support Greece and to keep the Eurozone intact. However, the foundations to this "solution" to the

Eurozone debt crisis are still weak and events could easily conspire to put this into reverse.

2.4 **The US economy** has only been able to manage weak growth in 2012 despite huge efforts by the Federal Reserve to stimulate the economy by liberal amounts of quantitative easing (QE) combined with a commitment to a continuation of ultra low interest rates into 2015. Unemployment levels have been slowly reducing but against a background of a fall in the numbers of those available for work. The fiscal cliff facing the President at the start of 2013 has been a major dampener discouraging business from spending on investment and increasing employment more significantly in case there is a sharp contraction in the economy in the pipeline. However, the housing market does look as if it has, at long last, reached the bottom and house prices are now on the up.

2.5 Hopes for a broad based recovery have, therefore, focused on the **emerging markets**. However, there are increasing concerns over flashing warning signs in various parts of the Chinese economy that indicate it could be in risk of heading for a hard landing rather than a gradual slow down.

3. The UK economy

3.1 The Government's austerity measures, aimed at getting the public sector deficit into order, have now had to be extended in the autumn statement over a longer period than the original four years. Achieving this new extended time frame will still be dependent on the UK economy returning to a reasonable pace of growth towards the end of this period. It was important for the Government to retain investor confidence in UK gilts so there was little room for it to change course other than to move back the timeframe.

3.2 Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is seen as a safe haven from Eurozone debt. There is, though, little evidence that consumer confidence levels are recovering nor that the manufacturing sector is picking up. On the positive side, growth in the services sector rebounded in Q3 and banks have made huge progress since 2008 in shrinking their balance sheets to more manageable levels and also in reducing their dependency on wholesale funding. However, availability of credit remains tight in the economy and the Funding for Lending scheme, which started in August 2012, has not yet had time to make a significant impact. Finally, the housing market remains tepid and the outlook is for house prices to be little changed for a prolonged period.

3.3 **Economic Growth.** Economic growth has basically flat lined since the election of 2010 and, worryingly, the economic forecasts for 2012 and beyond were revised substantially lower in the Bank of England Inflation quarterly report for August 2012 and were then further lowered in the November Report. Quantitative Easing (QE) was increased again by £50bn in July 2012 to a total of £375bn. Many forecasters are expecting the MPC to vote for a further round of QE to stimulate economic activity regardless of any near-term optimism. The announcement in November 2012 that £35bn will be transferred from the Bank of England's Asset Purchase Facility to the Treasury (representing coupon payments to the Bank by the Treasury on gilts held by the Bank) is also effectively a further addition of QE.

3.4 **Unemployment.** The Government's austerity strategy has resulted in a substantial reduction in employment in the public sector. Despite this, total employment has increased to the highest level for four years as over one million jobs have been created in the private sector in the last two years.

3.5 **Inflation and Bank Rate.** Inflation has fallen sharply during 2012 from a peak of 5.2% in September 2011 to 2.2% in September 2012. However, inflation increased to 2.7% in October though it is expected to fall back to reach the 2% target level within the two year horizon.

3.6 **AAA rating.** The UK continues to enjoy an AAA sovereign rating. However, the credit rating agencies will be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years.

4. Sector's forward view

4.1 Economic forecasting remains difficult with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains relatively fragile and whilst there is still a broad range of views as to potential performance, expectations have all been downgraded during 2012. Key areas of uncertainty include:

- the potential for the Eurozone to withdraw support for Greece at some point if the Greek government was unable to eliminate the annual budget deficit and the costs of further support were to be viewed as being prohibitive, so causing a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;

- inter government agreement on how to deal with the overall Eurozone debt crisis could fragment; the impact of the Eurozone crisis on financial markets and the banking sector;

- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to manufactured goods;

- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that are unlikely to be achieved;

- the risk of the UK's main trading partners, in particular the EU and US, falling into recession ;

- stimulus packages failing to stimulate growth;

- elections due in Germany in 2013;

- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

- the potential for action to curtail the Iranian nuclear programme

- the situation in Syria deteriorating and impacting other countries in the Middle East

4.2 The focus of so many consumers, corporates and banks on reducing their borrowings, rather than spending, will continue to act as a major headwind to a return to robust growth in western economies.

4.3 Given the weak outlook for economic growth, Sector sees the prospects for any changes in Bank Rate before 2015 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

4.4 Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. The interest rate forecast in this report represents a balance of downside and upside risks. The downside risks have already been commented on. However, there are specific identifiable upside risks as follows to PWLB rates and gilt yields, and especially to longer term rates and yields: -

- UK inflation being significantly higher than in the wider EU and US causing an increase in the inflation premium in gilt yields

- Reversal of QE; this could initially be allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held

- Reversal of Sterling's safe haven status on an improvement in financial stresses in the Eurozone

- Investors reverse de-risking by moving money from government bonds into shares in anticipation of a return to worldwide economic growth

3.1 The possibility of a UK credit rating downgrade (Moody's has stated that it will review the UK's AAA rating at the start of 2013).

4. Interest Rate Forecasts 2012 - 2016 - The below table shows Sector's latest forecast of interest rate movements to March 2016, and includes forecasts published by UBS and Capital Economics (an independent forecasting consultancy).

Sector's Interest Rate View															
	Now	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.40%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%	1.40%	1.70%	1.90%
6 Month LIBID	0.56%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%	1.60%	1.90%	2.20%
12 Month LIBID	0.92%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%	1.80%	2.10%	2.40%
5yr PWLB Rate	1.66%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
10yr PWLB Rate	2.64%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
25yr PWLB Rate	3.88%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
50yr PWLB Rate	4.04%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
Bank Rate															
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate															
Sector's View	1.66%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
UBS	1.66%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.66%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	-	-	-	-	-
10yr PWLB Rate															
Sector's View	2.64%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
UBS	2.64%	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	-	-	-	-	-
Capital Economics	2.64%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	-	-
25yr PWLB Rate															
Sector's View	3.88%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
UBS	3.88%	4.00%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	-	-	-	-	-
Capital Economics	3.88%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-	-	-	-	-
50yr PWLB Rate															
Sector's View	4.04%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
UBS	4.04%	4.10%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	-	-	-	-	-
Capital Economics	4.04%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-