REPORT FOR: **CABINET**

Date:	13 February 2014
Subject:	Treasury Management Strategy Statement, Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy for 2014/15
Key Decision:	Yes
Responsible Officer:	Simon George, Director of Finance and Assurance
Portfolio Holder:	Councillor Tony Ferrari, Portfolio Holder for Finance
Exempt:	No
Decision subject to Call-in:	Yes, except for the Recommendation to Council
Enclosures:	Appendix 1 - Legislation and Regulations Impacting on Treasury Management Appendix 2 - Treasury Management Delegations and Responsibilities Appendix 3 - Interest Rate Forecasts 2014/2017 Appendix 4 - Economic Background

Section 1 – Summary and Recommendations

This report sets out the Council's Treasury Management Strategy Statement, Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2014/15.

Recommendations:
The Cabinet is requested to recommend the Council to approve:
- Treasury Management Strategy Statement and Prudential Indicators for 2014/15;
- Minimum Revenue Provision Policy Statement for 2014/15;

Harrow COUNCIL LONDON

- Annual Investment Strategy for 2014/15;
- That the lower limit for borrowing of between 5 and 10 years be reduced from 10% to 5%;
- That the limit of investments for over one year be increased to £30m for 1-2 years and £10m for over 2 years; and

The Cabinet is requested to agree that this report be referred to Governance, Audit and Risk Management Committee for review.

Reason: (For recommendation)
To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

Section 2 – Report

1. INTRODUCTION

1.1 Background

1. The Chartered Institute of Public Finance and Accountancy (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."

   The Council has adopted this definition.

2. 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.

3. 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.

4. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and Treasury Management Code of

Practice to set Treasury and Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

5. The Act, the Codes and subsequent Investment Guidance (2010) requires the Council to set out its Treasury Strategy for Borrowing and to prepare an Annual Investment Strategy that establishes the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. In 2011 CIPFA updated both their Code of Practice and Prudential Code and, in 2013 issued revised guidance notes. All the changes are fully reflected in this strategy statement. At the request of Governance, Audit and Risk Management Committee (GARMC) a summary of the relevant legislation, regulations and guidance is included as Appendix 1.

6. The budget for each financial year includes the revenue costs that flow from capital financing decisions. Under the Code of Practice, increases in capital expenditure should 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 affordable within the projected income of the Council for the foreseeable future.

7. 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.

8. The Council recognises 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.

1.2 CIPFA Requirements

9. The Council has formally adopted CIPFA's Code of Practice on Treasury Management (revised November 2011). 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 ("TMPs") that 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 Half-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.

1.3 Reporting Requirements

10. As introduced above, the Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

    Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:
    - the capital plans (including prudential indicators);
    - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
    - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
    - an investment strategy (the parameters on how investments are to be managed).

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

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

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

11. The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and treasury management practices to the Section 151 officer. The Section 151 Officer chairs the Treasury Management Group (TMG), which consists of the Head of Technical Finance and Accountancy and the Treasury and Pension Fund Manager, to monitor the treasury management activity and market conditions. Copies of reports received by the TMG are provided to all the Members of GARMC.

12. Further details of responsibilities are given in Appendix 2.

1.4 Training

13. The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny.

14. During the year the Members of the GARMC participated in a training session using a self assessment form which helped them to consider the effectiveness of their scrutiny of treasury management activity. They have subsequently received additional information to assist them and, at the end of the year, will report to the Council on their scrutiny activities.

15. The training needs of treasury management officers are periodically reviewed as part of the Learning and Development programme. The officers attend various seminars and conferences throughout the year.

1.5 Treasury management consultants

16. The Council has engaged Capita Asset Services, Treasury Solutions as its external treasury management adviser.

17. 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 external service providers.

18. 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 is assessed are properly agreed and documented, and subjected to regular review.

1.6 Treasury Management Strategy for 2014/15

19. The Strategy covers:-

Capital issues

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

Treasury management issues

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

20. It is not considered necessary to produce a separate treasury strategy for the Housing Revenue Account (HRA) in light of the co-mingling of debt and investments between HRA and the General Fund. Where appropriate, details of allocations of balances and interest to HRA are contained in this report.

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

21. The Council's capital expenditure plans are the key drivers of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist Members' overview and confirm capital expenditure plans. The values shown in the tables below for 2012-13 and 2013-14 are actual and forecast outturn respectively and not the strategy for those years.

2.1 Capital expenditure

22. 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.

Table 1 Capital Expenditure and Funding

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	**Forecast Outturn**	**Estimate**	**Estimate**	**Estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Expenditure					
Non - HRA	24,288	56,965	69,571	47,812	39,768
HRA	7,554	7,464	9,527	12,227	8,412
TOTAL	**31,842**	**64,429**	**79,098**	**60,039**	**48,180**
Funding:-					
Grants	7,389	21,610	46,675	27,928	21,265
Capital receipts	5,081	3,578	13,483	13,627	2,030
Revenue financing	8,068	7,511	7,428	7,797	8,382
Section 106	76	190	366	1,965	0
TOTAL	**20,614**	**32,889**	**67,952**	**51,317**	**31,677**
Net financing need for the year	**11,228**	**31,540**	**11,146**	**8,722**	**16,503**

23. As will be discussed later in this report the Council expects to maintain balances at a level that is likely to make external borrowing unnecessary.

2.2 The Council's borrowing need (Capital Financing Requirement)

24. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is 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 new capital expenditure, which has not immediately been paid for, will increase the CFR.

25. 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 asset's life.

26. 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 funding facility and so the Council is not required to separately borrow for these schemes. The Council currently has £22m of such schemes within the CFR.

Table 2 Capital Financing Requirement

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	Forecast Outturn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Capital Financing Requirement as at 31 March					
Non – HRA	251,388	268,907	264,985	259,553	261,851
HRA	149,574	149,549	149,524	149,499	149,474
TOTAL	**400,962**	**418,456**	**414,509**	**409,052**	**411,325**
Annual change in CFR					
Non – HRA	-1,681	17,519	-3,922	-5,432	2,298
HRA	-27	-25	-25	-25	-25
TOTAL	**-1,708**	**17,494**	**-3,947**	**-5,457**	**2,273**

Table 3 Capital Financing Requirement – reasons for annual change

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	Forecast Outturn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Net financing need	11,228	31,540	11,146	8,722	16,503
Lease liability	554	500	500	500	500
Less MRP for PFI and Leases	-2,040	-2,035	-2,034	-2,035	-2,035
Less MRP	-11,450	-12,511	-13,559	-12,644	-12,695
TOTAL	**-1,708**	**17,494**	**-3,947**	**-5,457**	**2,273**

a) General Fund CFR will broadly remain around £260 million as the capital programme (net of grants and receipts) broadly matches MRP in the three years from 1st April 2014. For HRA, all new expenditure is funded from revenue as HRA is at its borrowing limit.

b) Total CFR over the five years' period is broadly similar to that estimated last year. The balances are in excess of actual external debt (including finance leases) due to internal balances used to part fund capital expenditure.

2.3 Minimum Revenue Provision

27. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. The accounting approach is to spread the cost over the period during which such assets are used to provide services to the local community. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by which capital

expenditure which is financed by borrowing or credit arrangements is funded by Council Tax and housing rents. The purpose of MRP is to enable the Council to make prudent provision to redeem its debt liability over a period that is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits.

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

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

- *From 1 April 2008 for all unsupported borrowing (including PFI and finance leases), the MRP policy will be Asset life method (option 3) and 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).*

- *A voluntary MRP may be made from either revenue or voluntarily set aside capital receipts and will be applied to the remaining life of the assets.*

- *Estimated life periods will be determined under delegated powers and will generally follow those set out in the guidance. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate:*

    a. *In the case of new capital expenditures which serve to add to the value of an existing capital asset, these will be estimated to have the remaining useful life as the asset whose value is enhanced.*
    b. *Freehold land cannot properly have a life attributed to it, so for the purposes of Asset Life method it will be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate will be used for the land.*

2.4 Affordability Prudential Indicators

29. The previous sections cover the overall capital expenditure and financing requirements 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.

2.5 Ratio of Financing Costs to Revenue Stream

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

Table 5 Ratio of Financing Costs to Revenue Stream

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	Forecast Outturn	Estimate	Estimate	Estimate
	%	%	%	%	%
Non - HRA	11	13	14	14	15
HRA	48	45	43	44	45

2.6 Incremental Impact of Capital Investment Decisions on Council Tax and Housing Rents

31. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme compared to the Council's existing approved commitments and current plans

Table 6 Incremental Impact of Capital Investment Decisions

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	Forecast Outturn	Estimate	Estimate	Estimate
	£	£	£	£	£
Incremental impact of capital investment decisions					
Increase in Council Tax (band D) per annum	17.20	62.87	11.43	10.65	43.40
Increase in average housing rent per week	16.11	-0.35	-0.14	1.46	2.33

2.8 Local HRA indicators

32. The latest CIPFA guidance suggests that the Council be aware of the following ratios when making its treasury management decisions.

Table 7 HRA Ratios

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	Forecast Outturn	Estimate	Estimate	Estimate
Debt (CFR) (£m)	149.6	149.5	149.5	149.5	149.5
Gross Revenue Stream (£m)	29.2	30.8	31.7	32.3	33.0
Ratio of Gross Revenue Stream to Debt (%)	**19**	**21**	**21**	**22**	**22**
Average Number of Dwellings	4,958	4,936	4,904	4,869	4,834
Debt outstanding per dwelling (£)	**30,173**	**30,287**	**30,485**	**30,704**	**30,927**

The ratio of gross revenue stream to debt shows a gradual increase which indicates that the ability of HRA to finance its debt is improving.

As the number of dwellings reduces over the period, the debt outstanding per dwelling is estimated to increase. However, the annual increases are only marginal and the ratio compared to the average value of each dwelling is low enough for the measure to raise no concern.

2.9 Housing Revenue Account (HRA) Major Repairs Allowance (MRA)

33. The National Subsidy system was replaced by Self Financing on 01 April 2012 as part of the Government's reform of the HRA. As a result, the Council will make a charge for depreciation in respect of its dwellings calculated on a componentised basis, which will be counted as a genuine charge against the HRA. Under the National Subsidy system, the Council made a charge equal to the Major Repairs Allowance receivable from Central Government thereby ensuring a nil overall effect for depreciation.

34. The Government has allowed Councils to continue to charge depreciation at an amount equal to the Major Repairs Allowance for the next four years under transitional arrangements to permit Council's to adapt to the new framework. The Council has decided, however, to move to componentised depreciation, as recommended by proper practices, as this gives a fairer reflection of future investment requirements.

35. As the value of housing stock is expected to increase broadly in line with inflation, HRA debt as a proportion of the value of housing stock will decline. If it is considered asset lives are not being sufficiently maintained, provision to repay borrowing will be made and reflected in the HRA Business Plan.

3. BORROWING

36. The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This involves both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

37. The latest position on actual borrowings and investments is as shown below:

Table 8 Treasury Position as at 31 December 2013

		Principal		Ave. rate
		£m	£m	%
Fixed rate funding	PWLB	218.5		
	Market	131.8	350.3	**4.30**
Variable rate funding			0	
Other long term liabilities (PFI & leases)			22.4	
Total Debt			**372.7**	
Total Investments			**142.5**	**1.16**

38. The Council's treasury portfolio position with forward projections is summarised below. The table shows the actual external debt, against the underlying capital borrowing need, highlighting any over or under borrowing.

Table 9 Changes to Gross Borrowing

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	**Forecast Outturn**	**Estimate**	**Estimate**	**Estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Debt 1st April	350,261	350,261	340,261	334,261	334,261
Expected change in debt	0	-10,000	--6,000	0	0
Other long term liabilities (OLTL) 1st April	25,156	23,676	22,121	20,586	19,051
Expected change in OLTL	-1,480	-1,535	-1,535	-1,535	-1,535
Borrowings on behalf of External Bodies	-2,927	0	0	0	0
Actual gross debt at 31st March	**371,010**	**362,402**	**354,847**	**353,312**	**351,777**
Capital Financing Requirement 31st March	**400,962**	**418,456**	**414,509**	**409,052**	**411,325**
Under / (over) borrowing	**29,952**	**56,054**	**59,662**	**55,740**	**59,548**

39. Debt outstanding should not normally exceed CFR. The expectation is that the under borrowing will increase as cash balances are used to fund debt repayment.

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

41. The Director of Finance and Assurance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

42. The table below shows the net borrowing after investment balances are taken into account. Net debt is forecast to remain consistent over the period as capital expenditure plans are financed from the cash generated by the MRP for existing assets.

Table 10 Net Borrowing

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	Forecast Outturn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
brought forward 1 April	294,681	273,284	243,937	256,382	254,847
carried forward 31 March	273,284	243,937	256,382	254,847	253,312
Change in net borrowing	**-21,397**	**-29,347**	12,445	-1,535	-1,535

3.2 Treasury Indicators: limits to borrowing activity

The Operational Boundary

43. This is the limit which external debt is not normally expected to exceed.

44. The boundary is based on current debt plus anticipated net financing need for future year.

The Authorised Limit for External Debt.

45. This is a further key prudential indicator which represents a control on the maximum level of borrowing. It represents a limit beyond which external debt is prohibited. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term. It relates to the financing of capital plans by both external borrowing and other forms of liability, such as credit arrangements.

46. 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.

Table 11 Operational boundary and authorised limit

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	Forecast Outturn	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
Authorised Limit for external debt					
Borrowing and finance leases	372	362	414	409	411
Operational Boundary for external debt					
Borrowing	350	340	345	354	371
Other long term liabilities	22	22	22	22	22

Total	372	362	367	376	393
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing	350	340	345	354	371
Upper limit for variable rate exposure					
Net principal re variable rate borrowing	0	0	0	0	0
Upper limit for principal sums invested over 364 days	25	25	40	40	40

HRA Debt Limit

47. Separately, the Council is also limited to a maximum HRA CFR (Debt limit) through the HRA self-financing regime. This limit is shown in the table below.

Table 12 HRA Debt Limit

	2012/13	2013/14	2014/15	2015/16	2016/17
	Actual	**Forecast Outturn**	**Estimate**	**Estimate**	**Estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
HRA Debt Limit	149.648	149.648	149.648	149.648	149.648
HRA CFR	149,574	149,549	149,524	149,499	149,474
Headroom	74	99	124	149	174

3.3 Prospects for Interest Rates

48. The treasury adviser has provided the commentary in the remainder of this section 3.3 and a more detailed economic commentary is included as Appendices 3 and 4.

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

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2014	0.50	2.50	4.40	4.40
Jun 2014	0.50	2.60	4.50	4.50
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.60	4.60
Mar 2015	0.50	2.80	4.60	4.70
Jun 2015	0.50	2.80	4.70	4.80
Sep 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.10	5.00	5.10
Jun 2016	0.75	3.20	5.10	5.20
Sep 2016	1.00	3.30	5.10	5.20
Dec 2016	1.00	3.40	5.10	5.20
Mar 2017	1.25	3.40	5.10	5.20

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive in indicating that growth prospects are strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

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

- *As for the Eurozone, concerns have subsided considerably in 2013. However, sovereign debt difficulties have not gone away and major concerns 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 to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;*
- *Investment returns are likely to remain relatively low during 2014/15 and beyond;*
- *Borrowing interest rates have risen significantly during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring even higher borrowing costs, which are now looming ever closer, where authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt, in the near future;*
- *There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.*

3.4 Borrowing Strategy

49. As shown in Table 10 above, currently the Council has a debt portfolio of £350 million, mainly long term, with an average maturity of 36 years. Investment balances have remained high and at 31 December 2013 were £142.5m. With the investment portfolio yielding around 1% and the average cost of debt 4.3%, there is a substantial short term

cost to carrying excessive debt. The same picture is true if investment rates are compared with new borrowing rates.

50. The Council has borrowed £83.8 million under Lender Option, Borrower Option (LOBO) structures with maturities between 2050 and 2078. In exchange for an interest rate that was below that offered on long term debt by the PWLB, the lender has the option at the end of five years (and half yearly thereafter) to reset the interest rate. If the rate of interest changes, the Council is permitted to repay the loan at no additional cost.

51. As shown in Table 9 above the Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (CFR), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent with investment returns low and counterparty risk relatively high.

52. In the past there has been an assumption that future capital expenditure plans will require additional borrowing in the medium term. Net capital expenditure within the General fund is being constrained with a large proportion grant funded and the need for additional borrowing is now less likely. The only foreseen circumstances in which new long term borrowing in the next three years might be required therefore, are either if part of the LOBO portfolio had to be refinanced early, or if made available to fund new affordable housing development, on the basis that there was no revenue impact on the General Fund. Even then, the preference would be to reduce investment balances unless the gap between investment and borrowing rates has narrowed. Lower cash balances have the additional benefit of reducing exposure both to interest rate movements and also to counterparty default.

53 It may be necessary to resort to temporary borrowing from the money markets or other local authorities to cover mismatches in timing between capital receipts and payments. However with several Government grants now paid early in the financial year this is not very likely.

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

55. The Council has adopted a single pooled approach for debt. Allocations to HRA are based on its CFR, with interest charged to HRA at the average rate on all external borrowing. With HRA's CFR expected to remain at its cap for at least the next three years, there will no change in HRA borrowing in that period. Longer term, HRA's ability to repay borrowing will depend on future revenues and capital expenditure plans.

3.6 Treasury Management Limits on Activity

56. There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if

these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance.

Upper limit on variable interest rate exposure

57. This identifies a maximum limit for variable interest rates based upon the debt position net of investments. As shown in Table 12 above the Council does not expect to undertake any borrowing on this basis.

Upper limit on fixed interest rate exposure

58. This identifies a maximum limit for fixed interest rates based upon the debt position net of investments. The Council's limits are shown in Table 12 above

Maturity Structure of Borrowing

59. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

60. The Council has no variable rate borrowing and the comments below relate only to its fixed rate portfolio.

61. In the table below, the maturity structure for the LOBO debt, in accordance with CIPFA Guidance, is shown as the first date that the interest rate can be increased.

Table 13 Maturity Structure of Fixed Rate Borrowing

	As at 31.12.2013 %	**Upper limit %**	**Lower limit %**
Under 12 months	14.2	20	0
12 months to 23 months	0.0	20	0
24 months to under 5 years	17.1	30	0
5 years to under 10 years	7.7	40	10
10 years and over	61.0	90	30

62. Exposure to debt maturing in 5 to 10 years is below the lower boundary. The most recent borrowing has been long term to take advantage of the historically low interest rates on offer and also to protect against the impact of early LOBO repayment. Whilst this position will eventually self correct this is unlikely to be for several years and it is therefore recommended that the lower limit be reduced to 5%.

3.7 Policy on Borrowing in Advance of Need

63. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

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

3.8 Debt rescheduling

65. The reasons for any rescheduling to be considered will include:
    - the generation of cash savings and / or discounted cash flow savings;
    - helping to fulfil the treasury strategy;
    - enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

66. Opportunities to reduce the cost of debt by premature repayment or to improve the maturity profile are kept under review in discussion with the Council's treasury adviser. Early repayment of market loans is by negotiation and would only be considered if the Council is approached by the lender. For PWLB loans, there are daily published prices for early repayment that allows analysis of the opportunities for restructuring. There is currently a spread which has generally made restructuring uneconomic. However, with longer term borrowing rates higher than short term rates and investment returns, there are potential savings from either repaying long term debt from cash balances or switching to shorter term debt. To date such opportunities have been declined as the overall debt level was expected to be maintained and any repaid debt would have to be replaced at a longer term adverse cost. With capital expenditure plans being constrained, the level of required debt will be monitored and if deemed excessive, early redemption will be considered.

67 Should any of the LOBO loans with interest rate reset dates in 2013-14 (£33.8 million) require refinancing, the most likely source will be a combination of internal cash and external borrowing to protect the budget. The ratio will depend on the relative cost of the existing and replacement debt.

68. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely.

69. All rescheduling will be reported to Cabinet at the earliest meeting following the exercise.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

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

71. In accordance with the above guidance and in order to minimise the risk to investments, the Council below clearly stipulates the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies. The treasury adviser monitors counterparty ratings on a real time basis with knowledge of any changes advised electronically as the agencies notify modifications.

72. Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to assess continually 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 adviser to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

73. 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.

74. The aim of the strategy is to generate a list of highly creditworthy counterparties which will provide security of investments, enable divesification and minimise risk.

75. Investment instruments identified for current use are listed in paragraphs 81 and 82 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices.

4.2 Creditworthiness policy

76. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

77. The Director of Finance and Assurance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

78. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria.

79. Credit rating information is supplied by the treasury management consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

80. The Council's criteria for an institution to become a counterparty are:

Specified Investments

81. These are sterling investments of a maturity period of not more than 364 days, or those which could be for a longer period but where the lender has the right to be repaid within 364 days if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. The instruments and credit criteria to be used are set out in the table below.

Instrument	**Minimum Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	Government backed	In-house
Term deposits – other LAs	Local Authority issue	In-house
Term deposits – banks and building societies	AA- Long Term F1+Short-term 2 Support AA- Viability UK or AAA Sovereign	In-house
Money Market Funds	AAA	In-house

Non-Specified Investments

82. Non-specified investments are any other type of investment (i.e. not defined as Specified above). They normally offer the prospect of higher returns but carry a higher risk. The identification and rationale supporting the selection of these other investments are set out below.

	Minimum Credit Criteria	**Use**	**Max % of total investments**	**Max. maturity period**
Term deposits – banks and building societies	A Long Term F1 Short-term 1 Support A Viability UK or AAA Sovereign	In-house	50%	3 months
Callable Deposits	A Long Term F1 Short term	In-house	20%	3 months

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
	1 Support			
UK nationalised Banks [Lloyds / HBOS]	F1 Short-term 1 Support	In-house	50%	36 months
UK nationalised Banks [RBS]	F2 Short-term 1 Support	In-house	50%	36 months
Enhanced Cash Funds	AAA	In-house	25% (maximum £10 million per fund)	Minimum monthly redemption

Unless specified above, individual bank & building society counterparty limits that are consistent with the above limits are approved by the Section 151 Officer in accordance with the Council's Treasury Management Practices.

4.3 Country limits

83. The Council has determined that it will only use approved counterparties from the UK or from countries with a minimum sovereign credit rating of AAA. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.3 Investment strategy

84. **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).

85. **Investment returns expectations.** Bank Rate has remained unchanged at 0.5% since March 2009 and is forecast to remain unchanged before starting to rise from quarter 2 of 2016. Bank Rate forecasts for financial year ends are:
    - 2013/14 0.50%
    - 2014/15 0.50%
    - 2015/16 0.50%
    - 2016/17 1.25%

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

87. **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.

88. The Council's current limit for investments of over 364 days is £25m. In view of the level of balances estimated to be available for investment over the next few years and the probability that longer term interest rates will remain higher than short term it is recommended that from 1 April 2014 this limit be increased from £25m to £40 with the following constraints:

12 – 24 months	£30m
Over 24 months	£10m

89. For its cash flow generated balances, the Council will seek to utilise its instant access RBS Special Interest Bearing Account and notice accounts, money market funds and short-dated deposits (overnight to100 days) in order to benefit from the compounding of interest.

90. As regards returns and potential returns Capita comment as follows:

*We remain in a very difficult investment environment. Whilst counterparty risk appears to have eased, it remains at elevated levels and economic forecasts abound with uncertainty. However, we also have a very accommodating monetary policy - reflected in a 0.5% Bank Rate, several tranches of quantitative easing and the Funding for Lending initiative. As a consequence, authorities are not getting much of a return from deposits! Against this backdrop it is, nevertheless, easy to forget recent history, ignore market warnings and search for that extra return to ease the revenue budget. In this respect we are seeing an increase in investment "opportunities" being offered to clients or being discussed in the wider pres*s

91. No amendments are proposed to the counterparty policy though close attention will be paid to Government intentions to sell off its stake in Lloyds and RBS. This will gradually remove the additional security offered by Government ownership which is a key element in sustaining the Council's current investment strategy.

92. Management of the investment portfolio over the last year has involved two specific challenges – further downgrades to the credit ratings of some banks and the decline in yields. Most recently two of the ratings agencies have downgraded RBS, one of the Council's most important counterparties but, bearing in mind the Government support for this bank, the Council has agreed to adjust the minimum credit criteria to allow its continued use as a counterparty. To prevent the portfolio being even more concentrated, the Council has also agreed to investment in enhanced cash funds two of which have been used during the year.

93. As evidence of the continued drop in yields, the best one year rate currently available is 0.98%, somewhat lower than the 1.1% available a year ago and considerably lower than the 3% received two years ago. The yield enhancement for investing over 2 and 3 years remains low. At the short end, rates on the RBS Special Interest Bearing Account started the year at 0.65%, fell in July to 0.5% and will fall further to 0.25% in February 2014. Additionally, during the year, investments made in the past at relatively high rates came to maturity and had to be replaced with much lower yielding investments. The overall result is that during 2013-14 the yield is likely to be approximately 1.5%, a significant reduction from the 1.8% earned in 2012-13.

94. The current strategy permits a maximum maturity of 3 years for Lloyds and RBS and y 3 months for all other banks. The maximum maturities are in line with guidance from

Capita, with the extended maturities for the two part nationalised banks reflecting the increased security of their ownership by the UK Government. This level of security has enabled the Council to agree a limit of 50% of the total investments for each of them.

95. As a result of the Council's strategy and the interest rates available the investment portfolio has inevitably remained concentrated with RBS and Lloyds with 74% of the total portfolio invested with them on 31st December 2013. However, in terms of diversification this is an improvement on the 93% invested with these two banks as at 31 December 2012.

96. The Council's funds are mainly cash flow derived and include the General Fund, West London Waste Authority (until 31 March 2014) and HRA. Balances are also held to support capital expenditure. From 1st April 2011, pension fund cash balances have been held separately from those of the Council. A separate investment strategy has not been developed for the pension fund and all its cash is held on overnight call account with RBS.

97. The counterparty policy recognises the uncertainty within the financial sector by limiting deposits to three months for those banks that are not UK government owned or the higher rated specified investments. Selective deposits with maturities of over three months will be made with Lloyds / HBOS and RBS to obtain the benefit of the higher rates on offer provided that prudent liquidity is maintained. In no event will more than £40m be invested for maturities of more than 12 months.

98. Due to the low interest rates environment and uncertainties around Government funding for banks, setting expected income levels for 2014-15 and beyond is imprecise. Investment income (net of allocations) has been budgeted at £1,052,000 for 2014/15 (2013/14 £1,572,000).

Financial Implications

99. Financial matters are integral to the report.

Legal Implications

100. The report has been reviewed by Legal Department and comments received are incorporated into the report.

Environmental Impact

101. There are no direct environmental impacts.

Performance Issues

102. The Council meets the requirements of the CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practices for the Treasury Management function.

103. A major part of the report covers the Council's establishment of its prudential indicators and its performance against them and other measures over the current year and the next three years. This includes:

- Capital expenditure and capital financing requirement
- Ratios of financing costs to revenue streams and assets
- Borrowing limits and interest payable
- Investment limits and interest receivable

Risk Management Implications

104. There is a risk that the Council could lose a deposit due to the failure of a Counterparty and any movement in interest rates will have an impact on the investment income and borrowing costs.

Risk included on Directorate risk register? Yes

Separate risk register in place? No

Equalities Implications

105. Officers have considered any possible equalities impact and consider that there is no adverse equalities impact.

Corporate Priorities

106. This report deals with the Treasury Management Strategy which is a key to delivering the Council's corporate priorities

Section 3 - Statutory Officer Clearance

Name: Simon George Date: 20 January 2014	x	Chief Financial Officer
Name: Linda Walker Date: 21 January 2014	x	on behalf of the Monitoring Officer

Section 4 – Performance Officer Clearance

Name: Alex Dewsnap Date: 20 January 2014	x	Divisional Director Strategic Commissioning

Section 5 – Environmental Impact Officer Clearance

Name: Andrew Baker Date: 20 January 2014	x	on behalf of the Corporate Director (Environment & Enterprise)

Section 6 - Contact Details and Background Papers

Contact: Ian Talbot (Treasury and Pension Fund Manager) Tel: 020-8424-1450 / Email: ian.talbot@harrow.gov.uk

Background Papers: N/A

Call-In Waived by the Chairman of Overview and Scrutiny Committee	**NOT APPLICABLE** *[Call-in applies, except to the Recommendations to Council]*

APPENDIX 1

LEGISLATION AND REGULATION IMPACTING ON TREASURY MANAGEMENT

The following items numbered 1 - 4 show the sequence of legislation and regulation impacting on the treasury management function. The sequence begins with primary legislation, moves through Government guidance and Chartered Institute of Public Finance and Accountancy (CIPFA) codes of practice and finishes with implementation through the Council's own Treasury Management Practices.

1. Local Government Act 2003

Link below

Local Government Act 2003

Below is a summary of the provisions in the Act dealing with treasury management.

In addition the Secretary of State is empowered to define the provisions through further regulations and guidance which he has subsequently done through statutory instruments, Department of Communities and Local Government Guidance and CIPFA codes of practice.

Power to borrow

The Council has the power to borrow for purposes relevant to its functions and for normal treasury management purposes – for example, to refinance existing debt.

Control of borrowing

The main borrowing control is the duty not to breach the prudential and national limits as described below.
The Council is free to seek loans from any source but is prohibited from borrowing in foreign currencies without the consent of Treasury, since adverse exchange rate movements could leave it owing more than it had borrowed.
All of the Council's revenues serve as security for its borrowing. The mortgaging of property is prohibited.
It is unlawful for the Council to 'securitise', that is, to sell future revenue streams such as housing rents for immediate lump-sums.

Affordable borrowing limit

The legislation imposes a broad duty for the Council to determine and keep under review the amount it can afford to borrow. The Secretary of State has subsequently defined this duty in more detail through the Prudential Code produced by CIPFA, which lays down the practical rules for deciding whether borrowing is affordable.
It is for the Council (at a meeting of the full Council) to set its own 'prudential' limit in accordance with these rules, subject only to the scrutiny of its external auditor. The Council is then free to borrow up to that limit without Government consent. The Council is free to vary the limit during the year, if there is good reason.

Requirements in other legislation for the Council to balance its revenue budget prevents the long-term financing of revenue expenditure by borrowing.
However the legislation does confer limited capacity to borrow short-term for revenue needs in the interests of cash-flow management and forseeable requirements for temporary revenue borrowing are allowed for when borrowing limits are set by the Council.

The Council is allowed extra flexibility in the event of unforeseen needs, by being allowed to increase borrowing limits by the amounts of any payments which are due in the year but have not yet been received.

Imposition of borrowing limits

The Government has retained reserve power to impose 'longstop' limits for national economic reasons on all local authorities' borrowing and these would override authorities' self-determined prudential limits. Since this power has not yet been used the potential impact on the Council is not known.

Credit arrangements

Credit arrangements (eg property leasing, PFI and hire purchase) are treated like borrowing and the affordability assessment must take account not only of borrowing but also of credit arrangements. In addition, any national limit imposed under the reserve powers would apply to both borrowing and credit.

Power to invest

The Council has the power to invest, not only for any purpose relevant to its functions but also for the purpose of the prudential management of its financial affairs.

2. Department for Communities and Local Government Investment Guidance (March 2010)

The Local Government Act 2003 requires a local authority "…..to have regard (a) to such guidance as the Secretary of State may issue………….." and the current guidance became operative on 1 April 2010.

The Guidance recommends that for each financial year the Council should prepare at least one investment Strategy to be approved before the start of the year. The Strategy must cover:

- **Investment security –**
  Investments should be managed prudently with security and liquidity being considered ahead of yield
  Potential counterparties should be recognised as “specified” and “non-specified” with investment limits being defined to reflect the status of each counterparty

- **Investment risk**
  Procedures should be established for monitoring, assessing and mitigating the risk of loss of invested sums and for ensuring that such sums are readily accessible for expenditure whenever needed.
  The use of credit ratings and other risk assessment processes should be explained
  The use of external advisers should be monitored
  The training requirements for treasury management staff should be reviewed and addressed
  Specific policies should be stated as regards borrowing money in advance of need

- **Investment Liquidity**
  The Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed

The Strategy should be approved by the full Council and made available to the public free of charge. Subject to full Council approval, or approved delegations, the Strategy can be revised during the year.

3. Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA 2011)

The primary requirements of the Code are:

- 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 (“TMPs”) that 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 Half-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.

4. The Prudential Code for Capital Finance in Local Authorities (CIPFA 2011)

Compliance with the objectives of the Code by the Council should ensure that:

- Capital expenditure plans are affordable in terms of their implications on Council Tax and housing rents
- External borrowing and other long term liabilities are within prudent and sustainable levels
- Treasury management decisions are taken in accordance with good professional practice

As part of the two codes of practice above the Council is required to:

- agree a series of prudential indicators against which performance is measured
- produce Treasury Management Practice Notes for officers which set out how treasury management policies and objectives are to be achieved and activities controlled.

Appendix 2

Treasury Management Delegations and Responsibilities

The respective roles of the Cabinet, GARMC, the Section 151 officer, the Treasury Management Group and the Treasury Team are summarised below. Further details are set out in the Treasury Practice Notes.

The main responsibilities and delegations in respect of treasury activities are:

Council

Council will approve the annual treasury strategy, including borrowing and investment strategies. In doing so Council will establish and communicate their appetite for risk within treasury management having regard to the Prudential Code

Cabinet

Cabinet will recommend to Council the annual treasury strategy, including borrowing and investment strategies and receive a half-year report and annual out-turn report on treasury activities.

Cabinet also approves revenue budgets, including those for treasury activities.

Governance, Audit and Risk Monitoring Committee

GARMC is responsible for ensuring effective scrutiny of the Treasury strategy and policies.

Section 151 Officer

Council has delegated responsibility for the implementation and monitoring of treasury management decisions to the Section 151 Officer to act in accordance with approved policy and practices. In particular, the Sector 151 Officer:

- Approves all new borrowing, investment counterparties and limits and changes to the bank mandate,
- Chairs the Treasury Management Group ("TMG"), and
- Approves the selection of treasury advisor and agrees terms of appointment.

Treasury Management Group

Monitors the treasury activity against approved strategy, policy, practices and market conditions.

Approves changes to treasury management practices and procedures.

Reviews the performance of the treasury management function using benchmarking data on borrowing and investment provided by Sector.

Monitors the performance of the appointed treasury advisor and recommends any necessary actions.

Ensures the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.

Monitors the adequacy of internal audit reviews and the implementation of audit recommendations.

Treasury and Pension Investment Manager

Has responsibility for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Policy Statement and CIPFA's 'Standard of Professional Practice on Treasury Management'.

Treasury Team

Undertakes day to day treasury investment and borrowing activity in accordance with strategy, policy, practices and procedures and recommends changes to these to the TMG.

Interest Rate Forecasts 2014 – 2017

APPENDIX 3

Capita Asset Services Interest Rate View	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
3 Month LIBID	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.70%	0.90%	1.30%
6 Month LIBID	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.70%	0.80%	1.00%	1.20%	1.40%
12 Month LIBID	0.80%	0.80%	0.80%	0.80%	0.80%	0.80%	1.00%	1.20%	1.40%	1.60%	1.80%	2.00%	2.30%
5yr PWLB Rate	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
10yr PWLB Rate	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
25yr PWLB Rate	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
50yr PWLB Rate	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
UBS	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	2.60%	2.60%	2.60%	2.60%	2.70%	2.80%	3.00%	3.20%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
UBS	3.70%	3.80%	3.90%	4.05%	4.05%	4.30%	4.55%	4.55%	-	-	-	-	-
Capital Economics	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	4.05%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
UBS	4.55%	4.55%	4.80%	4.80%	5.05%	5.05%	5.30%	5.30%	-	-	-	-	-
Capital Economics	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.45%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%
UBS	4.45%	4.45%	4.70%	4.70%	4.90%	4.90%	5.05%	5.05%	-	-	-	-	-
Capital Economics	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.60%	-	-	-	-	-

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

Appendix 4

Economic Background

THE UK ECONOMY

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

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

Forward surveys are currently very positive in indicating that growth prospects are also strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates.

Forward guidance. The Bank of England issued forward guidance in August which stated that the Bank will not start to consider raising interest rates until the jobless rate (Labour Force Survey / ILO i.e. not the claimant count measure) has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years in August, but revised to possibly quarter 4 2014 in November. The UK unemployment rate has already fallen to 7.4% on the three month rate to October 2013 (although the rate in October alone was actually 7.0%). The Bank's guidance is subject to three provisos, mainly around inflation; breaching any of them would sever the link between interest rates and unemployment levels. This actually makes forecasting Bank Rate much more complex given the lack of available reliable forecasts by economists over a three year plus horizon. The recession since 2007 was notable for how unemployment did NOT rise to the levels that would normally be expected in a major recession and the August Inflation Report noted that productivity had sunk to 2005 levels. There has, therefore, been a significant level of retention of labour, which will mean that there is potential for a significant amount of GDP growth to be accommodated without a major reduction in unemployment.

However, it has been particularly encouraging that the strong economic growth in 2013 has also been accompanied by a rapid increase in employment and forward hiring indicators are also currently very positive. It is therefore increasingly likely that early in 2014, the MPC will need to amend its forward guidance by reducing its 7.0% threshold rate and/or by adding further wording similar to the Fed's move in December (see below).

Credit conditions. While Bank Rate has remained unchanged at 0.5% and quantitative easing has remained unchanged at £375bn in 2013, the Funding for Lending Scheme (FLS) was extended to encourage banks to expand lending to small and medium size enterprises. The second phase of Help to Buy aimed at supporting the purchase of second hand properties, will also start in earnest in January 2014. These measures have been so successful in boosting the supply of credit for mortgages, and so of increasing house purchases, (though levels are still far below the pre-crisis level), that the Bank of England announced at the end of November that the FLS for mortgages would end in February 2014. While there have been concerns that these schemes are creating a bubble in the housing market, house price increases outside of London and the south-east have been much weaker. However, bank lending to small and medium enterprises continues to remain weak and inhibited by banks still repairing their balance sheets and anticipating tightening of regulatory requirements.

Inflation. Inflation has fallen from a peak of 3.1% in June 2013 to 2.1% in November. It is expected to remain near to the 2% target level over the MPC's two year time horizon.

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

THE GLOBAL ECONOMY

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

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

USA. The economy has managed to return to robust growth in Q2 2013 of 2.5% y/y and 4.1% y/y in Q3, in spite of the fiscal cliff induced sharp cuts in federal expenditure that kicked in on 1 March, and increases in taxation. The Federal Reserve therefore decided in December to reduce its $85bn per month asset purchases programme of quantitative easing by $10bn. It also amended its forward guidance on its pledge not to increase the central rate until unemployment falls to 6.5% by adding that there would be no increases in the central rate until 'well past the time that the unemployment rate declines below 6.5%, especially if projected inflation continues to run below the 2% longer run goal'. Consumer, investor and business confidence levels have all improved markedly in 2013. The housing market has turned a corner and house sales and increases in house prices have returned to healthy levels. Many house owners have, therefore, been helped to escape from negative equity and banks have also largely repaired their damaged balance sheets so that they can resume healthy levels of lending. All this portends well for a reasonable growth rate looking forward.

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

CAPITA ASSET SERVICES FORWARD VIEW

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

There could well be volatility in gilt yields over the next year as financial markets anticipate further tapering of asset purchases by the Fed. The timing and degree of tapering could have a significant effect on both Treasury and gilt yields. Equally, while the political deadlock and infighting between Democrats and Republicans over the budget has almost been resolved the raising of the debt limit, has only been kicked down the road. A final resolution of these issues could have a significant effect on gilt yields during 2014.

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

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

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

Downside risks currently include:

- UK strong economic growth is currently very dependent on consumer spending and recovery in the housing market. This is unlikely to endure much beyond 2014 as most consumers are maxed out on borrowing and wage inflation is less than CPI inflation, so disposable income is being eroded.

- A weak rebalancing of UK growth to exporting and business investment causing a major weakening of overall economic growth beyond 2014

- Weak growth or recession in the UK’s main trading partners - the EU and US, depressing economic recovery in the UK.

- Prolonged political disagreement over the raising of the US debt ceiling.

- A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.

- A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.

- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.

- The Italian political situation is frail and unstable; this will cause major difficulties in implementing austerity measures and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.

- Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts, especially if it looks likely that one, or more countries, will need to leave the Eurozone.

- A lack of political will in France, (the second largest economy in the EZ), to dynamically address fundamental issues of low growth, poor international uncompetitiveness and the need for overdue reforms of the economy.

- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.

- Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds.

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

- A sharp upturn in investor confidence that sustainable robust world economic growth is firmly expected, causing a surge in the flow of funds out of bonds into equities.

- A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone.

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

- In the longer term – an earlier than currently expected reversal of QE in the UK; this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.