REPORT FOR: CABINET

Date of Meeting:	26 June 2014
Subject:	Treasury Management Outturn 2013/14
Key Decision:	No
Responsible Officer:	Simon George, Director of Finance and Assurance
Portfolio Holder:	Councillor Sachin Shah, Portfolio Holder for Finance and Major Contracts
Exempt:	No
Decision subject to Call-in:	No
Wards affected:	All
Enclosures:	Appendix 1 - Prudential Indicators Appendix 2 – New Investments Undertaken During 2013-14 Appendix 3 - Economic Background Appendix 4 – Counterparty policy Appendix 5 – Legislation and Regulations Impacting on Treasury Management Appendix 6 – Treasury Management Delegations and Responsibilities

Harrow COUNCIL
LONDON

Section 1 – Summary and Recommendations

This report sets out the summary of treasury management activities for 2013/14

Recommendations:

(a) Note the outturn position for treasury management activities for 2013/14.

(b) Refer this report to the Governance, Audit, Risk Management and Standards Committee for review.

Reasons: (For recommendation)

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

(b) To keep Cabinet Members informed of treasury management activities and performance.

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. At the request of the former Governance, Audit and Risk Management Committee a summary of the relevant legislation, regulations and guidance is included as Appendix 5.

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 Reporting Requirements

9. 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 - 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 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 Governance, Audit, Risk Management and Standards Committee.

10. 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 Governance, Audit, Risk Management and Standards Committee.

11. Further details of responsibilities are given in Appendix 6.

1.3 Matters covered in report

12. This main matters covered in the report are:

- Treasury management outturn
- Treasury position as at 31 March 2014,
- Borrowing outturn
- Investment outturn
- Compliance with treasury limits and Prudential Indicators.
- Economic background

1.4 Options considered

13. For the reasons discussed above no options other than those recommended were considered.

2. TREASURY MANAGEMENT OUTTURN

14. There was a favourable variance of £0.9m on the revised capital financing budget of £19.9m as detailed below:-

	Latest Budget	Outturn	Variation	
	£000	**£000**	**£000**	**%**
Cost of Borrowing	8,231	8,266	35	0.4%
Investment Income	-1,597	-1,822	-225	-14.1%
Minimum Revenue Provision	13,234	12,508	-726	-5.5%
Total	**19,868**	**18,952**	**-916**	**-4.5%**

The favourable outcome arose due to:

(a) Borrowing – gross borrowing costs are slightly above budget whilst the costs allocated to the HRA are slightly below budget producing a net variance of £35,000.
(b) Income - the average rate of interest earned was 1.34%. This rate compares favourably with three months LIBOR of 0.52% and the Council's peer group of other London boroughs. The budget was based on an interest rate of 1.7% and, whilst the actual rate earned of 1.34% was lower, higher average balances (£150m compared to a budget assumption of approximately £105m) provided the opportunity to realise more investment income than estimated.
(c) MRP - The favourable variance results from project slippage on completion timetables

15. The returns from the investment portfolio are benchmarked by the treasury management adviser, Capita. At the end of the year the weighted average return of the investment portfolio calculated by Capita at 1.11% exceeded both their risk adjusted model portfolio (0.92%) and the average of other London boroughs (0.79%). Similar results were achieved at the end of each of the previous three quarters in the year.

3. TREASURY POSITION AS AT 31 MARCH 2014

16. The Council's debt and investment position at the beginning and the end of the year was as follows:

	31 March 2014	**Average Rate at 31 March 2014**	**Average Life**	31 March 2013	Average Rate at 31 March 2013	Average Life
	£m	**%**	**Years**	£m	%	Years
Fixed Rate Borrowing						
Public Works Loan Board (PWLB)	218.5	4.09	37.2	218.5	4.09	38.2
Market	121.8	4.58	36.1	131.8	4.65	34.4
Total Debt	**340.3**	**4.26**	**36.8**	**350.3**	**4.30**	36.8
Investments:						
In-House	130.8	1.11	174 days	103.2	2.14	276 days
Total Investments	**130.8**			**103.2**		

The above analysis assumes loans structured as LOBOs (see paragraph 19 below for definition and further details) mature at the end of the contractual period. If the first date at which the lender can reset interest rates was used as the maturity date, the average life for market loans would be 1.7 years and for the whole debt portfolio 24.5 years.

4. BORROWING OUTTURN

17. Total long term debt of £340.3m at the end of March 2014 is made up £121.8m market loans and £218.5m from the PWLB.

18. There was no additional borrowing during the year and the only repayment a sum of £10m repaid to Dexia Credit on 31 March 2014. The table below sets out the borrowing maturity profile.

	31st March 2014		31st March 2013	
	£m	**%**	£m	%
Under 12 Months	6.0	1.7	10.0	2.9
12 Months and under 24 Months			6.0	1.7
24 Months and within 5 years	20.0	5.9	10.0	2.8
5 years and within 10 years	17.0	5.0	27.0	7.7
10 years and above	297.3	87.4	297.3	84.9
Total	**340.3**	**100.0**	350.3	100.0

19. In aggregate there are £83.8m of Lender Option Borrower Option (LOBO) structured loans shown in the table above as having maturities of between 36 and 64 years. The lenders are permitted to reset interest rates five years after the loan is drawn and either semi-annually or annually thereafter. Should interest rates on these loans increase, the Council has the option to repay at no cost. The table below restates the maturity profile by including LOBO loans at their first interest reset date.

	31st March 2014	
	£m	**%**
Under 12 Months	69.8	20.5
12 Months and under 24 Months	20.0	5.9
24 Months and within 5 years	20.0	5.9
5 years and within 10 years	17.0	5.0
10 years and above	213.5	62.7
Total	**340.3**	**100.0**

20. The approach to funding capital expenditure, as discussed in the February 2013 strategy and subsequently, is to use internal funds wherever possible in recognition of the unfavourable gap between investment returns and borrowing costs. Consideration continues to be given as to the cost and benefits of the premature repayment of debt and the premium which would be incurred. However, in view of the cost and the estimated future requirements of the capital programme, which could necessitate further borrowings, it was not felt to be appropriate to make any premature repayments during 2013-14.

5. INVESTMENT OUTTURN

21. The Bank of England base rate has remained at 0.5% since March 2009 while 7 day and 3 month Libid rates continued to decline ending the year at 0.34% and 0.36% respectively making investing over short terms unattractive. Despite these

unattractive rates the investment portfolio achieved an average return of 1.34% in the year through concentrating investments with the two part UK Government owned banks that offered superior returns.

22. The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list. The treasury strategy permits investments for a range of periods from overnight to three years, dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Further details of the credit quality of counterparties are given in Appendix 4.

23. The investment portfolio is mostly (72%) invested with two banks, Lloyds / HBOS (42%) and RBS (30%). The counterparty policy permits 50% to be invested in each of these banks.

24. Advantage has been taken of the available limits with Lloyds and RBS. Not only did they offer higher interest rates than the other UK banks but the longer permitted maturities also enhanced returns.

25. As at 31 March 2014 the investment portfolio is invested over a spread of maturities up to three years. At the year end £22m matures in more than 12 months taking advantage of the longer term rates available. This is just below the maximum (£25m) permitted by the strategy. These deposits yield between 1.1% and 1.6%, somewhat higher than one year deposits which yield around 1% and very short term of under 0.5%. A listing of new investments of 3 months or more in the year is included in Appendix 2.

26. The table below sets out the investment balances as at 31 March 2014.

	31st March 2014		31st March 2013	
	£m	**%**	£m	%
Specified Investments				
Banks & Building Societies	0.0	0.0	0.1	0.1
Money Market Funds	1.6	1.2	0.0	0.0
Non –Specified Investments				
Banks & Building Soc.	129.2	98.8	103.1	99.9
Total	**130.8**	**100.0**	103.2	100.0

Included in the above balances are funds of £11.9 million invested on behalf of the West London Waste Authority and Pension Fund balances of £1.7 million. Most pension fund cash balances are held in separate banks accounts in the name of the fund. In aggregate 11% of interest earned is allocated both to the WLWA and to internal funds (schools, housing, insurance etc).

6. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

27. The prudential framework for local authority capital investment was introduced through the Local Government Act 2003. The prudential system provides a flexible framework approach within which capital assets can be procured, managed, maintained and developed. Under this framework, individual authorities are responsible for deciding the level of their affordable borrowing for the Council's

capital investment plans that is demonstrated to be affordable, prudent and sustainable.

28. The Act and the supporting regulations require the Council to have regard to the Prudential Code and to set Prudential Indicators for the next three years. The indicators for 2013/14 were approved by the Cabinet on 14 February 2013. During the financial year the Council operated within the treasury limits and Prudential Indicators as shown in Appendix 1.

7. MINIMUM REVENUE PROVISION (MRP)

29. Under the statutory regulations a Minimum Revenue Provision is made each year to repay the outstanding debt on assets. This is calculated by spreading the capital expenditure over the useful life of the asset as detailed in the strategy.

8. ECONOMIC BACKGROUND

30. The Council has engaged Capita Asset Services, Treasury Solutions as its external treasury management adviser. Appendix 3 comprises a commentary on the UK and Global economies as prepared during April 2014.

9. IMPLICATIONS OF THE RECOMMENDATIONS

31. Since the recommendations are asking the Cabinet only to note the position on treasury management activities and are not seeking any decisions they have no implications for the Council's resources and costs.

32. The recommendations do not affect the Council's staffing / workforce and have no equalities or community safety impact.

10. LEGAL IMPLICATIONS

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

11. FINANCIAL IMPLICATIONS

34. Financial matters are integral to the report.

12. PERFORMANCE ISSUES

35. 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.

36. As part of the Code the Council must agree a series of prudential indicators and measure its performance against them. These indicators and performance are detailed in Appendix 1. In most cases performance has been in accordance with the indicators and, where it has not, explanations are provided.

13. ENVIRONMENTAL IMPACT

37. There are no direct environmental impacts.

14. RISK MANAGEMENT IMPLICATIONS

38. The identification, monitoring and control of risk are central to the achievement of the treasury objectives. Potential risks are identified, mitigated and monitored in accordance with treasury practice notes approved by the Treasury Management Group.

Risk included on Directorate risk register? Yes
Separate risk register in place? No

15. EQUALITIES IMPLICATIONS

39. There is no direct equalities impact.

16. CORPORATE PRIORITIES

40. This report deals with the Treasury Management Strategy which plays a significant part in supporting the delivery of all the Council's corporate priorities.

Section 3 - Statutory Officer Clearance

Name: Simon George Date: 23 May 2014	x	Chief Financial Officer
Name: Linda Cohen Date: 20 May 2014	x	on behalf of the Monitoring Officer

Section 4 – Performance Officer Clearance

Name: Alex Dewsnap Date: 22 May 2014	x	Divisional Director Strategic Commissioning

Section 5 – Environmental Impact Officer Clearance

Name: Venetia Reid-Baptiste Date: 20 May 2014	x	on behalf Corporate Director (Environment & Enterprise)

Ward Councillors notified:	**NO – all wards affected**

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: None

Call-In Waived by the Chairman of Overview and Scrutiny Committee	**NOT APPLICABLE** *[Decisions for noting are not subject to Call-in]*

APPENDIX 1

PRUDENTIAL INDICATORS 2013/14 OUTTURN

Table 1 - Capital Expenditure and Funding

	2012/13	2013/14	2013/14
	Actual	Revised	Actual
	£'000	£'000	£'000
Capital Expenditure			
Non - HRA	24,288	85,095	29,022
HRA	7,554	8,390	6,261
TOTAL Expenditure	**31,842**	**93,485**	**35,283**
Funding:-			
Grants	7,389	37,553	9,468
Capital Receipts and Contributions	5,157	4,117	4,536
Revenue Financing	8,068	8,932	6,689
Total Funding	**20,614**	**50,602**	**20,693**
Borrowing to Fund the Capital Programme	**11,228**	**42,883**	**14,590**
Total new Borrowing	**11,228**	**42,883**	**14,590**

The above table summarises actual and revised capital expenditure plans and the sources of funding. The funding excludes the Minimum Revenue Provision (depreciation on General Fund assets) which offsets the need for external borrowing. Further detail and explanations are contained within the Revenue and Capital Outturn report.

The General Fund capital expenditure of £29m is lower than the revised programme resulting in a variance of £56m. The slippage totalling to £35m will be carried forward into 2014-15.

From an affordability perspective, which is the treasury consideration, the reduction in expenditure has impacted favourably on interest income. The majority of HRA's capital expenditure of £6.2 million is funded from revenue sources.

Table 2 - Ratio of Financing Costs to Net Revenue Stream

	2012/13	2013/14	2013/14
	Actual	Approved	Actual
	%	%	%
Ratio of financing costs to net revenue stream			
Non - HRA	11.55	12.51	11.66
HRA	47.76	47.67	35.74

These ratios consider the affordability of capital expenditure by comparing interest costs and depreciation with net revenues. A ratio that increases indicates that capital costs take a larger share of resources.

Both ratios are below that approved in the strategy and lower than those projected mid year indicating an improved position.

Table 3 - Incremental Impact of Capital Investment Decisions

	2012/13	2013/14	2013/14
	Actual	Approved	Actual
	£	£	£
Incremental impact of capital investment decisions			
Increase in Council Tax (Band D) per annum	17.20	20.59	28.45
Increase in average housing rent per week	16.11	-2.39	-11.59

The incremental ratios identify the impact of the cost of debt and depreciation (MRP) applicable to new capital borrowing on council taxes and rents.

The capital expenditure and commitments to be funded from Council Tax remained as agreed in the original Treasury Management Strategy Statement but a lower level of capital receipts than expected has adversely affected the above ratio.

Table 4 - Borrowing and Capital Financing Requirement

	2012/13	2013/14	2013/14
	Actual	Approved	Actual
	£'000	£'000	£'000
Capital Financing Requirement	401,292	414,101	401,252
Gross borrowing	369,216	360,357	361,775
Under borrowing	**32,076**	**53,744**	**39,477**
Net borrowing requirement			
brought forward 1 April	294,681	274,232	273,284
carried forward 31 March	273,284	280,908	230,942
In year borrowing requirement	**-21,397**	**6,676**	**-42,342**

The first three indicators are designed to highlight borrowing in advance of need.

The net borrowing requirement looks at the change in debt less investment balances. The decrease of £42m is due mainly to an increase in investment balances partly reflecting a slippage on the capital programme and grants received in advance for schools.

Table 5 - Capital Financing Requirement

	2012/13	2013/14	2013/14
	Actual	Approved	Actual
	£'000	£'000	£'000
Capital Financing Requirement as at 31 March			
Non – HRA	251,718	264,487	251,714
HRA	149,574	149,614	149,538
Total	**401,292**	**414,101**	**401,252**
Annual change in CFR			
Non – HRA	-1,681	12,699	-4
HRA	-27	40	-36
Total	**-1,708**	**12,739**	**-40**

The Capital Financing Requirement is the historic outstanding capital expenditure that has not been allocated to revenue. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure that is funded from borrowing increases the CFR. The value of finance leases is included. The CFR value is greater than the outstanding borrowing (including finance leases) of £362 million, indicating the level of cash generated by revenue balances.

Table 6 - Borrowing and Investment Limits

	2012/13	2013/14	2013/14
	Actual	**Approved**	**Actual**
	£m	**£m**	**£m**
Authorised Limit for external debt			
Borrowing and finance leases	372	414	362
Operational Boundary for external debt			
Borrowing	350	352	340
Other long term liabilities	22	23	22
Total	372	375	362
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing	350	352	340
Upper limit for variable rate exposure			
Net principal re variable rate borrowing	0	0	0
Upper limit for principal sums invested over 364 days	25	25	22

The approved operational boundary for debt is based on actual debt at the start of the year plus the net projected capital expenditure in the year. The authorised limit is based on CFR balances and includes an allowance for delayed capital receipts. Total borrowing has been within both limits during the year. Investments with greater than 12 months to maturity at 31 March are £22m but had been equal to the limit of £25m for much of the year.

APPENDIX 2

NEW INVESTMENTS UNDERTAKEN FOR PERIODS OF OVER 3 MONTHS

Counterparty	Date invested	Period	Principal (£m)	Interest rate (%)
Lloyds TSB	3 April 2013	1 year	5.0	1.10
Lloyds TSB	18 April 2013	1 year	5.0	1.10
Ignis Asset Management	30 April 2013	Unrestricted	10.0	Variable
Lloyds TSB	2 May 2013	1 year	5.0	1.10
Insight Liquidity Funds	16 May 2013	Unrestricted	10.0	Variable
Bank of Scotland	16 May 2013	1 year	5.0	1.05
Lloyds TSB	4 July 2013	1 year	5.0	1.01
Royal Bank of Scotland	20 August 2013	2 years	5.0	1.16
Lloyds TSB	17 October 2013	1 year	10.0	0.98
Royal Bank of Scotland	28 January 2014	3 years	5.0	1.62
Lloyds TSB	29 January 2014	1 year	5.0	0.95

APPENDIX 3

ECONOMIC BACKGROUND - SUMMARY

- After strong UK GDP growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013 [April to December], it appears that strong growth will continue into 2014 as forward surveys are very encouraging. There are also positive indications that recovery is starting to broaden away from reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. This strong growth has resulted in unemployment falling much faster towards the threshold of 7%, set by the MPC last August, before it said it would consider any increases in Bank Rate. In the February 2014 Inflation Report, the MPC therefore broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of indicators. Accordingly, markets are expecting a first increase around the end of 2014, though recent comments from MPC members have emphasised they would want to see strong growth well established, and an increase in labour productivity / real incomes, before they would consider raising Bank Rate.
- Also encouraging has been the sharp fall in inflation (CPI), reaching 1.7% in February: forward indications are that inflation will continue to be subdued. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19.
- The Federal Reserve has continued with its monthly $10bn reductions in asset purchases which started in December; asset purchases have now fallen from $85bn to $55bn and are expected to stop by the end of 2014, providing strong economic growth continues this year.
- **Interest Rate forecast**

	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	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.25%	1.50%	1.75%
5yr PWLB rate	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.70%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.50%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.90%	5.00%	5.00%	5.10%	5.10%	5.10%
50yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%

Capita Asset Services undertook a review of its interest rate forecasts in February, after the Bank of England's latest quarterly Inflation Report. This latest forecast now includes a first increase in Bank Rate in quarter 4 of 2015 (previously quarter 2 of 2016), and reflects greater caution as to the speed with which the MPC will start increasing Bank Rate than the current [March 2014] expectations of financial markets.

Summary outlook

- Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. 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 was that wage inflation had been significantly below CPI inflation, so disposable income and living standards were being eroded, (although income tax cuts had ameliorated this to some extent). However, the recent fall in inflation has narrowed the gap between wage increases and inflation and this gap could narrow even more during this year, especially if there is also a recovery in growth in labour productivity (leading to significant increases in pay rates). With regard to the US, the main world economy, it faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

- As for the Eurozone, concerns subsided considerably during 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.

APPENDIX 4

COUNTERPARTY POLICY

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

Specified Investments

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

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 1 Support	In-house	20%	3 months
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

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 6

TREASURY MANAGEMENT DELEGATIONS AND RESPONSIBILITIES

The respective roles of the Cabinet, Governance, Audit, Risk Management and Standards Committee, 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, Risk Management and Standards Committee

Responsible for ensuring effective scrutiny of the treasury management 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 the Council's treasury management adviser.

Monitors the performance of the appointed treasury management adviser 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 Fund 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.