COUNCIL

20 FEBRUARY 2014

TREASURY MANAGEMENT STRATEGY 2014/2015

Portfolio Holder:	Councillor Alan Jarrett, Finance and Deputy Leader
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Summary

This report seeks approval to the Council's Treasury Management Strategy for the 2014/2015 financial year. The Treasury Management Strategy incorporates within it the Treasury Management Policy Statement, Annual Investment Strategy and Minimum Revenue Provision policy.

1. Budget and Policy Framework

1.1. Business Support Overview and Scrutiny is currently responsible for the scrutiny of the Council's Treasury Management, Investment Strategy and Minimum Revenue Provision Policy Statement. Section 16 of this report proposes that the Audit Committee undertakes the future scrutiny of the Treasury Management Strategy.

1.2. Council is asked to consider and approve the strategy taking into account the comments from the Business Support Overview and Scrutiny Committee and Cabinet. Final approval of the policy and the setting of prudential indicators is a matter for Council.

1.3. The decision as to approve the Treasury Management Strategy for 2014/2015 falls within the policy and budget framework.

2. Background

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

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

2.3. CIPFA defines treasury management as:

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

3. Reporting Requirements

3.1. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2011) was adopted by this Council on 24 January 2013.

3.2. The primary requirements of the Code are as follows:

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

3.3. The suggested strategy for 2014/2015 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Capita Asset Services.

3.4. In exercising the delegations to fulfil the responsibilities set out in the Treasury Management Strategy, the Council will establish a set of standards to govern the manner in which these responsibilities are exercised. These standards are referred to as the Treasury Management Practice statements and are supported by the requisite Schedules that flow from the exercise of those Practices. These documents were approved by Cabinet on 12 February 2013, and have been updated to reflect the amendment to Treasury practices flowing from this report as well as external sources. The amendments to the practices were agreed at Cabinet on 11 February 2014.

3.5. Specifically the elements that are changing are:
- Approved Countries
- Treasury and Prudential Indicators.
- The Authorised Limit and Operational Boundary for 2014/2015.

3.6. The strategy for 2014/2015 covers two main areas:

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

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

4. Treasury management consultants

4.1. The Council uses Capita Asset Services, Treasury Solutions (formerly Sector) as its external treasury management advisors.

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

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

5. The Prudential and Treasury Indicators 2014/2015 – 2016/2017

5.1. The Council's capital expenditure plans are the key driver 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.

5.2. Capital prudential indicators are summarised within Appendix 3. These indicators are a summary of the Council's capital expenditure and financing plans, currently reflecting the 2013/2014 approved programme but will need to be adjusted to accommodate additional resources for 2014/2015 and beyond as they become clear.

5.3. It is a statutory duty for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the “Affordable Borrowing Limit”. In England and Wales the authorised Limit represents the legislative borrowing limit.

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

5.5. Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years; details of the Authorised Limit can be found in Appendix 3 of this report.

5.6. The Prudential and Treasury indicators are set out in Appendix 3 to this report and are relevant for the purposes of setting an integrated treasury.

6. Treasury Management Strategy

6.1. The capital expenditure plans set out in Section 5 and Appendix 3 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 will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

7. Borrowing Requirement

7.1 No borrowing (with the possible exception of HRA or any new prudential schemes) is envisaged for the foreseeable future because of the relative position of investment returns and rates for new borrowing. With regard to any new borrowing, an assessment of the business and treasury position will be undertaken prior to deciding whether any borrowing will be carried out from internal or external sources. This is the policy that has been followed for a number of years now and as a consequence the Council is deemed to be significantly ‘under-borrowed’ (paragraph 10.1 refers). It is possible that this policy may need to be adapted to accommodate cash flow requirements i.e. if there is a consistent need to borrow to cover potential overdrafts then the internally funded capital investment will need to be substituted by external resource.

8. Prospects for interest rates

8.1. 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. Appendix 1 draws together a number of current City forecasts for short term (Bank Rate) and longer term fixed interest rates. The following table gives the Capita Asset Services central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 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

8.2. 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.

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

- 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 2014/2015 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.

8.4 A more detailed analysis of the economic outlook is detailed in Appendix 4

9. Borrowing strategy

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

9.2. Against this background and the risks within the economic forecast, caution will be adopted with the 2014/2015 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL* in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper RISE* in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the anticipated rate to US tapering of asset purchases, or in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

9.3. Any decisions will be reported to the appropriate decision making body at the next available opportunity.

10. Current portfolio position

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

Year End Resources	2013/14 Anticipated £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
External Debt	172,325	162,325	162,324	162,324
Debt at 1 April	162,325	162,324	162,324	162,324
Expected change in Debt	(10,000)	(1)	0	0
Other long-term liabilities (OLTL)	2,500	2,500	2,500	2,500
Expected change in OLTL	0	0	0	0
Actual gross debt at 31 March	**164,825**	**164,824**	**164,824**	**164,824**
The Capital Financing Requirement	**248,873**	**245,648**	**242,424**	**242,484**
Under / (over) borrowing	**84,048**	**80,824**	**77,600**	**77,660**

10.2. 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 2014/2015 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.

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

11. Policy on borrowing in advance of need

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

11.2. 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.

12. Debt rescheduling

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

12.2. The reasons for any rescheduling to take place will include:

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

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

12.4 Decisions related to rescheduling will be similarly be reported in reviews of this strategy.

13. Annual Investment Strategy

13.1. <u>Investment policy</u>

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

13.1.2. In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using our ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

13.1.3. Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Capita Asset Services in producing its colour coding which shows the varying degrees of suggested creditworthiness.

13.1.4. 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.

13.1.5. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

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

13.1.7. Investment instruments identified for use in the financial year are listed in Appendix 5 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices schedules.

13.1.8. As part of the 2013/14 mid year Treasury Management review it was agreed that fund would be withdrawn for our external Fund Manager Investec Asset Management due to continued poor performance. This process is be substantially complete by the end of the financial year with the exception of a UK Gilt valued at approximately £4m. Currently it is not financially prudent to prematurely withdraw from this investment. Our Treasury Advisors (Capita) have secured a company who will hold this Gilt to term on our behalf.

13.2. Creditworthiness policy

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

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

13.2.2. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

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

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

13.2.4. Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

13.2.5. All credit ratings will be monitored primarily via Capita Asset Services' updates by Officers on a continuous basis. The Council is alerted to changes to ratings of all three agencies through its use of our creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

13.2.6. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government Country limits.

13.3 Counterparty Limits

13.3.1 The current counterparty limits are a £20 million limit per counterparty and £25 million for counterparties with a duration rating of 12 months or above

11.3.2 No amendments are requested to these counterparty limits.

13.4 Country limits

13.4.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent), with the exception of United Kingdom, where there will be no restriction on the sovereign credit rating. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

13.4.2 The Country limit is reinforced by the application of a financial limit to investment such that a maximum of £40 million may be invested in any one country save the United Kingdom where no limit is imposed.

13.4 Investment strategy

13.4.1 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).

13.4.2 Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2013/14 0.50%
- 2014/15 0.50%
- 2015/16 0.50%
- 2016/17 1.25%

13.4.3 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.

13.5 End of year investment report

13.5.1 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

14. Kent County Council (KCC) Local Government Reorganisation (LGR) Debt

14.1 The charge for the share of KCC debt for which Medway Council was responsible on local government reorganisation is based on the current average cost of debt for the County Council as a whole. KCC rates had been decreasing year-on-year as the County took on cheaper new debt but this has recently marginally reversed with the loss of beneficial rates for short-term as they are repaid. Whilst the County rate at a projected 5.50% remains marginally higher than our own average debt rate of 4.23% for 2014/15, the margin between PWLB debt rates for new borrowing and restructured debt (currently 4.54% vs 3.41% for 25 year borrowing) is such that this saving would be negated by the penalty involved. The outstanding principal at 1 April 2015 will be £40 million.

Current and Historical Rates of Interest Charged on KCC LGR debt

Year	2008/09 Actual	2009/10 Actual	2010/11 Actual	2011/12 Actual	2012/13 Actual	2013/14 Estimate	2014/15 Estimate
Rate	5.51%	5.08%	5.21%	5.30%	5.44%	5.51%	5.50%

15. Minimum Revenue Provision (MRP)

15.1 The Minimum Revenue Provision is explained and the Policy Statement for 2014/2015 is set out at Appendix 2. The MRP calculation continues to be reviewed by officers, in order to apply the most financially advantageous and yet prudent approach to MRP. The introduction of the HRA Self-financing regime leaves it open for authorities to determine an MRP for the HRA but there is no necessity for making such a provision.

16. Treasury Management Reporting

16.1 As stated in paragraph 3.1 Full Council in January 2013 adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011. The Code sets out the reporting requirements and management information arrangements for Treasury Management and these are reflected within the Council's Constitution.

16.2 These requirements include the Cabinet and Council receiving reports on its treasury management policies, practices and activities including an annual strategy and plan in advance of the year, a mid-year review and the Audit Committee receiving an annual report after its close. In addition, the Council has nominated the Business Support Overview and Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy policies.

16.3 Members on both the Business Support Overview and Scrutiny Committee and the Audit Committee have recently reconsidered the reporting of Treasury Management. This was when the Treasury Management Strategy Mid-year review Report was reported to the Audit Committee, in order to relieve pressure on the Overview and Scrutiny Committee's work programme. Members have expressed their support for transferring responsibility for scrutinizing the treasury management function to the Audit Committee.

16.4 In line with Members wishes a number of changes to the Constitution are set out in Appendix 8, which would transfer responsibility to the Audit Committee. Should Members agree to the proposal, the effect of such a change is set out below (as tracked changes).

Area of responsibility	Council/Committee	Frequency
Treasury Management Policy Statement / Treasury Management Strategy / Annual Investment Strategy / MRP policy	~~Business Support Overview and Scrutiny~~ Audit Committee, Cabinet then Full Council	Annually before the start of the year (January-February)
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	~~Business Support Overview and Scrutiny~~ Audit Committee, Cabinet then Full Council	Mid year (January-February)
Treasury Management Policy Statement / Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Full Council	As and when necessary
Treasury Management Practices	~~Business Support Overview and Scrutiny~~ Audit Committee then Cabinet	Annually before the start of the year (January-February) and as and when amendments proposed
Treasury Management Monitoring Reports	Cabinet	Part of regular financial monitoring cycle
Annual Treasury Outturn Report	Cabinet then Audit Committee	Annually by 30 September after the end of the Year

16.5 It is noted that the CIPFA guidance on Treasury Management in the Public Services and on the Prudential Code for Capital Finance in Local Authorities both state that the scrutiny function of Treasury Management may be carried out either by the Audit Committee or an Overview and Scrutiny Committee. Furthermore these changes would not require any additional meetings of the Audit Committee.

17. Business Support Overview and Scrutiny Committee – 4 February 2014

17.1 The Business Support Overview and Scrutiny Committee considered this report on 4 February 2014.

17.2 The Committee's attention was drawn to paragraph 16 of the report on treasury management reporting and the proposed movement of scrutinising Treasury management from Business Support Overview and Scrutiny to Audit Committee.

17.3 Following consideration and recommendation by the Audit Committee of the mid year review of the Council's Treasury Management Strategy the Cabinet had agreed in December 2013 to withdraw funding from the external Fund Manager. The reason for this was that the Council's internal investment team had out-performed the Fund Manager for nine years out of the last ten. Investments would be taken back only as they came to term to avoid the

Council loses from selling early all funds will be returned by end March 2014 with the exception of a UK Gilt, this will be transferred to a caretaking fund manager until it matured, the Council does not have any experience with gilts and the fee was considered reasonable at £800 per annum.

17.4 Members also noted the circulation of a supplementary agenda that contained a revised version of Appendix 10 of the report.

17.5 Members then raised a number of issues and questions including:

- The average number of investment transactions Council Officers undertook -. Members noted that some investments were not touched for six to twelve months and others were handled on a daily basis because they were used to maintain the Council's cash flow balance. On average four or five transactions a day took place to maximise the use of the Council's money.

- Members noted that CDS was an abbreviation and meant Credit Default Swap.

17.6 Members referred to a reduction in back-office finance staff as a consequence of required efficiencies and the potential impact on the effectiveness of treasury management services. The Chief Finance Officer advised he was confident that the treasury management team would continue to provide a high standard of service and that, if required specialist advice would be sought from Capita, an external adviser to the Council.

17.7 The Business Support Overview and Scrutiny Committee noted the Treasury Management Strategy 2014/2015 and its revisions and forwarded its comments for consideration by Cabinet on 11 February 2014. The Committee also recommended the approval of the revised Treasury Management Practices as set out in the revised Appendix 10 to the report.

18. Cabinet – 11 February 2014

18.1 The Cabinet considered this report on 11 February 2014 and agreed the following:

18.2 Cabinet noted the comments of the Business Support Overview and Scrutiny Committee.

18.3 Cabinet recommended to Council the Treasury Management Strategy and associated policies and strategy statements as attached in Appendices 1-6 to the report.

18.4 Cabinet approved the amendments to the Treasury Management Practices as set out in Appendix 10 to the report.

18.5 Cabinet recommended to Council the revisions to the Constitution, as set out in Appendix 8 to the report, which will transfer responsibility for scrutinising the treasury management function to the Audit Committee.

19. Risk Management

19.1 As stated within the Treasury Strategy, a key driver for the review of the CIPFA code has been the exposure to risk evidenced by the Icelandic investments and more generally by the financial crisis. Risk and the management thereof is a feature throughout the strategy and in detail within the Treasury Management Practices 1 within the Treasury Strategy.

20. Diversity Impact Assessment

20.1 The Treasury Management Strategy does not directly impact on members of the public as it deals with 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. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group (Appendix 9).

21. Financial and Legal Implications

21.1 The finance and legal positions are set out throughout the main body of the report.

22. Recommendations

22.1 Cabinet recommends to Council the Treasury Management Strategy and associated policies and strategy statements as attached in Appendices 1-6 to the report.

22.2 Cabinet recommends to Council the revisions to the Constitution, as set out in Appendix 8 to the report, which will transfer responsibility for scrutinising the treasury management function to the Audit Committee.

Appendices

1. Interest rate forecasts 2013-2017
2. Minimum Revenue Provision Policy Statement 2014/15
3. Prudential and Treasury Indicators
4. Economic background
5. Specified and Non-Specified Investments
6. Approved countries for investments
7. The treasury management role of the section 151 officer
8. Scrutiny of Treasury Management
9. Diversity Impact Assessment

Lead officer contact

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Background papers

Council *Treasury Management Strategy*
Mid-Year Review Report 2012/13 24 January 2013
http://democracy.medway.gov.uk/mgconvert2pdf.aspx?id=18845

Cabinet *Treasury Management Strategy 2012/2013* 14 February 2012
http://democracy.medway.gov.uk/mgconvert2pdf.aspx?id=9427

Cabinet *Treasury Management Strategy*
Mid-Year Review Report 2013/14 17 December 2013
http://democracy.medway.gov.uk/mgconvert2pdf.aspx?id=22061

Appendix 1

Interest Rate Forecasts 2013-2017

Bank Rate	NOW	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
Capita Asset Services	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
UBS	**0.50%**	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%	0.50%	0.75%	-	-	-	-	-

5yr PWLB Rate	NOW	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
Capita Asset Services	**2.63%**	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	**2.63%**	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	**2.63%**	2.60%	2.60%	2.60%	2.60%	2.70%	2.80%	3.00%	3.20%	-	-	-	-	-

10yr PWLB Rate	NOW	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
Capita Asset Services	**3.72%**	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	**3.72%**	3.70%	3.80%	3.90%	4.05%	4.05%	4.30%	4.55%	4.55%	-	-	-	-	-
Capital Economics	**3.72%**	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	4.05%	-	-	-	-	-

25yr PWLB Rate	NOW	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
Capita Asset Services	**4.35%**	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	**4.35%**	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%	4.35%	4.45%	-	-	-	-	-

50yr PWLB Rate	NOW	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
Capita Asset Services	**4.31%**	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	**4.31%**	4.45%	4.45%	4.70%	4.70%	4.90%	4.90%	5.05%	5.05%	-	-	-	-	-
Capital Economics	**4.31%**	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.60%	-	-	-	-	-

Appendix 2

Minimum Revenue Provision Policy Statement 2014/15

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2007/2008*,* and assessed MRP for 2007/2008 onwards in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

In setting the Minimum Revenue Provision Policy, Medway Council has regard to the guidance and will set a policy to ensure a prudent provision for the repayment of debt.

The major proportion of the MRP for 2014/15 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 1 of the guidance.

Certain expenditure reflected within the debt liability at 31 March 2014 will, under delegated powers be subject to MRP under option 3*,* which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method (or annuity method if appropriate). For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

The Council will treat all expenditures as not ranking for MRP until the year after the scheme or asset to which they relate is completed and/or brought into use, rather than confine this approach solely to expenditures treated for MRP purposes under Option 3

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. 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.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

In the case of long term debtors arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements (such as long term investments), or where borrowing has occurred but will be repaid by future Capital Receipts or agreed income from other source, there will be no Minimum Revenue Provision made.

There is no requirement on the HRA to make a minimum revenue provision

Appendix 3

Prudential and Treasury Indicators

PRUDENTIAL INDICATORS	2014/2015	2015/2016	2016/2017
Extract from budget and rent setting report	**estimate**	**estimate**	**estimate**
	£'000	**£'000**	**£'000**
Capital Expenditure			
Non - HRA	24,399	7,162	1,747
HRA	8,577	8,734	5,255
TOTAL	32,976	15,896	7,002
Ratio of financing costs to net revenue stream			
Non - HRA	2.82%	3.00%	2.97%
HRA	17.54%	17.53%	17.45%
Gross borrowing requirement			
brought forward 1 April	162,324	162,324	162,324
carried forward 31 March	162,324	162,324	162,324
in year borrowing requirement	0	0	0
Capital Financing Requirement as at 31 March			
Non – HRA	203,124	196,673	196,952
HRA	42,524	45,750	45,532
TOTAL	245,648	242,424	242,484
Annual change in Cap. Financing Requirement			
Non – HRA	(6,233)	(6,451)	279
HRA	3,008	3,227	(218)
TOTAL	(3,225)	(3,225)	61
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	(5.06)	(1.08)	(4.50)
Increase in average housing rent per week	(0.15)	0.46	0.41

TREASURY MANAGEMENT INDICATORS	**2014/2015**	**2015/2016**	**2016/2017**
	estimate	**estimate**	**estimate**
	£'000	**£'000**	**£'000**
Authorised Limit for external debt -			
Borrowing	424,282	418,973	417,347
other long term liabilities	4,400	4,400	4,400
TOTAL	428,682	423,373	421,747
Operational Boundary for external debt -			
borrowing	385,711	380,885	379,406
other long term liabilities	4,000	4,000	4,000
TOTAL	389,711	384,885	383,406
Actual external debt	162,416	162,416	162,415
HRA Maximum CFR Debt Limit	45,846	45,846	45,846
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	100%	100%	100%
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments	40%	40%	40%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£150,000	£150,000	£150,000

TABLE 5: Maturity structure of fixed rate borrowing during 2012/2013	**upper limit**	**lower limit**
under 12 months	75%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

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.

Appendix 5

Specified and Non-Specified Investments

SPECIFIED INVESTMENTS:

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

	*** Minimum 'High' Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies	See note 1	In-house
Collateralised deposit (see note 3)	UK sovereign rating	In-house
Certificates of deposit issued by banks and building societies	See note 1 and 2	In-house
UK Government Gilts	UK sovereign rating	In-house buy and hold and Fund Manager
Bonds issued by multilateral development banks	AAA	In-house buy and hold
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	In-house buy and hold
Sovereign bond issues (other than the UK govt)	AAA	In-house buy and hold
Treasury Bills	UK sovereign rating	In house
Government Liquidity Funds	* Long-term AAA volatility rating V1+	In-house
Money Market Funds	* Long-term AAA volatility rating V1+	In-house

Note 1. Award of "Creditworthiness" Colour by Capita Asset Services as detailed in paragraph 13.2

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

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of 70% ** will be held in aggregate in non-specified investment

1. Maturities of ANY period

	*** Minimum Credit Criteria**	**Use**	**** Max % of total investments**	**Max. maturity period**
Fixed term deposits with variable rate and variable maturities: -Structured deposits	See note 1	In-house	£10m	Lower of 5 years or Capita Asset Services duration rating

2. Maturities in excess of 1 year

	*** Minimum Credit Criteria**	**Use**	**** Max % of total investments**	**Max. maturity period**
Term deposits – local authorities	--	In-house	40%	5 Years
Term deposits – banks and building societies	See note 1	In-house	40%	As per Capita Asset Services duration rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See note 1 and 2	In-house	40%	As per Capita Asset Services duration rating
Certificates of deposit issued by banks and building societies	See note 1 and 2	In-house	40%	As per Capita Asset Services duration rating
UK Government Gilts	UK sovereign rating	In-house and Fund Manager	40% In-house 100% Fund Manager	In-house see note 1,
Bonds issued by multilateral development banks	AAA	In-house	20% in-house	In-house see note 1,
Sovereign bond issues (other than the UK govt)	AAA	In-house	20% in-house	In-house see note 1

Note 1. Award of “Creditworthiness” Colour by Capita Asset Services as detailed in paragraph 13.2

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.
N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.

Appendix 6

Approved countries for investments

Based on lowest available rating

AAA

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

AA+

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

AA

- Abu Dhabi (UAE)
- France
- Qatar

AA-

- Belgium
- Saudi Arabia

Appendix 7

The treasury management role of the section 151 officer

The S151 (responsible) officer

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

Appendix 8

Scrutiny of Treasury Management

1. Audit Committee – amended terms of reference (tracked changes)

Audit Committee

- To provide independent assurance on the adequacy of the risk management framework and the associated control environment, including consideration of the Council's approach to risk management and the assurance framework, the production of the annual governance statement, arrangements for delivering value for money and the Council's anti-fraud arrangements and anti-corruption measures;

- To receive reports in line with the Council's whistleblowing, anti-bribery, covert surveillance policies and anti-money laundering policies;

- To monitor the Council's compliance with its own published standards and to consider any proposals for changes to Financial Rules, Codes of Practice on tenders and contracts;

- To monitor financial policies and processes, including endorsement of improvement plans to strengthen the control environment;

- To approve the annual governance statement;

- To approve the annual accounts ~~and annual treasury outturn report~~;

- To scrutinise the Council's treasury management, investment strategy, minimum revenue provision policy statement along with treasury management practices and associated schedules and approve the annual treasury outturn report;

- To discuss with the external auditor new accounting standards, changes to the reporting framework and the basis of the annual audit, including the content of performance work;

- To receive all reports by the external auditor including all performance reports and the annual audit and inspection letter;

- To oversee Internal Audit activity;

- To provide an independent review of the Council's financial and non-financial performance

2. Business Support Overview and Scrutiny Committee – amended terms of reference

Delete the following section and renumber subsequent sections accordingly:

(xix) to scrutinise the Council's treasury management, investment strategy, minimum revenue provision policy statement along with treasury management practices and associated schedules;

3. Financial Rules – amended paragraph 7.1(e) and 7.2 (f) (tracked changes)

7.1 (e): The Chief Finance Officer shall report to the ~~Business Support Overview and Scrutiny~~ Audit Committee, Cabinet and Council before the start of the new financial year on borrowing and investment strategies for the ensuing year and to Cabinet and Audit Committee not later than September on treasury management activities in the previous year.

7.2 (f) Council nominates ~~Business Support Overview and Scrutiny~~ Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy policies

Appendix 9

Diversity Impact Assessment: Screening Form

Directorate **BSD**	**Name of Function or Policy or Major Service Change** **Treasury Management Strategy**	
Officer responsible for assessment Andy Larkin	Date of assessment 17/01/14	New or existing? Existing

Defining what is being assessed		
1. Briefly describe the purpose and objectives	The Treasury Management Strategy, is the strategy that the Council applies to effectively manage it's Treasury Function. This is defined by CIPFA 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.*	
2. Who is intended to benefit, and in what way?	All stakeholders with a safe and effective Treasury Management Strategy	
3. What outcomes are wanted?	The successful and secure management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.	
4. What factors/forces could contribute/detract from the outcomes?	<u>Contribute</u> Effective Strategy, Good planning Effective use of information and intelligence	<u>Detract</u> Resources, Further cuts
5. Who are the main stakeholders?	The Chief Finance Officer, Full Council and residents	
6. Who implements this and who is responsible?	Chief Finance Officer, and the Treasury Team	

Assessing impact		
7. Are there concerns that there could be a differential impact due to *racial/ethnic groups*?	~~YES~~	Brief statement of main issue
	NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due racial or ethnic group membership.	
8. Are there concerns that there could be a differential impact due to *disability*?	~~YES~~	Brief statement of main issue
	NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due disability.	
9. Are there concerns that there could be a differential impact due to *gender*?	~~YES~~	Brief statement of main issue
	NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due gender.	
10. Are there concerns there could be a differential impact due to *sexual orientation*?	~~YES~~	Brief statement of main issue
	NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due sexual orientation.	
11. Are there concerns there could be a have a differential impact due to *religion or belief*?	~~YES~~	Brief statement of main issue
	NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of	

	the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due religion or belief.	
12. Are there concerns there <u>could</u> be a differential impact due to people's *age*?	~~YES~~ NO	Brief statement of main issue
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due to people's age.	
13. Are there concerns that there <u>could</u> be a differential impact due to *being trans-gendered or transsexual*?	~~YES~~ NO	Brief statement of main issue
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due an individual's gender identity.	
14. Are there any *other* groups that would find it difficult to access/make use of the function (e.g. speakers of other languages; people with caring responsibilities or dependants; those with an offending past; or people living in rural areas)?	~~YES~~ NO	If yes, which group(s)?
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact.	
15. Are there concerns there <u>could</u> be a have a differential impact due to *multiple discriminations* (e.g. disability <u>and</u> age)?	~~YES~~ NO	Brief statement of main issue
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact.	

<table>
<tr><td colspan="4">Conclusions & recommendation</td></tr>
<tr><td colspan="2" rowspan="2">16. Could the differential impacts identified in questions 7-15 amount to there being the potential for adverse impact?</td><td>~~YES~~</td><td rowspan="2">Brief statement of main issue</td></tr>
<tr><td>NO</td></tr>
<tr><td colspan="2" rowspan="2">17. Can the adverse impact be justified on the grounds of promoting equality of opportunity for one group? Or another reason?</td><td>YES</td><td rowspan="2">Please explain</td></tr>
<tr><td>NO</td></tr>
<tr><td colspan="4">Recommendation to proceed to a full impact assessment?</td></tr>
<tr><td>NO</td><td colspan="3">This function/ policy/ service change complies with the requirements of the legislation and there is evidence to show this is the case.</td></tr>
<tr><td>~~NO, BUT …~~</td><td>~~What is required to ensure this complies with the requirements of the legislation? (see DIA Guidance Notes)?~~</td><td colspan="2">~~Minor modifications necessary (e.g. change of ‘he’ to ‘he or she’, re-analysis of way routine statistics are reported)~~</td></tr>
<tr><td>~~YES~~</td><td>~~Give details of key person responsible and target date for carrying out full impact assessment (see DIA Guidance Notes)~~</td><td colspan="2"></td></tr>
</table>

<table>
<tr><td colspan="3">Action plan to make Minor modifications</td></tr>
<tr><td>Outcome</td><td>Actions (with date of completion)</td><td>Officer responsible</td></tr>
<tr><td></td><td></td><td></td></tr>
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<table>
<tr><td colspan="4">Planning ahead: Reminders for the next review</td></tr>
<tr><td>Date of next review</td><td colspan="3">January 2014</td></tr>
<tr><td>Areas to check at next review (e.g. new census information, new legislation due)</td><td colspan="3"></td></tr>
<tr><td>Is there another group (e.g. new communities) that is relevant and ought to be considered next time?</td><td colspan="3"></td></tr>
<tr><td colspan="2">Signed (completing officer/service manager)
Andy Larkin</td><td>Date</td><td>28/01/14</td></tr>
<tr><td colspan="2">Signed (service manager/Assistant Director)</td><td>Date</td><td></td></tr>
</table>

NB: Remember to list the evidence (i.e. documents and data sources) used