

REPORT FOR DECISION

Agenda Item	
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DECISION OF:	OVERVIEW & SCRUTINY COMMITTEE CABINET COUNCIL
DATE:	13 FEBRUARY 2013 20 FEBRUARY 2013 20 FEBRUARY 2013
SUBJECT:	TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2013/14
REPORT FROM:	CABINET MEMBER FOR FINANCE AND RESOURCES
CONTACT OFFICER:	MIKE OWEN, EXECUTIVE DIRECTOR OF RESOURCES STEPHEN KENYON, ASSISTANT DIRECTOR OF RESOURCES (FINANCE AND EFFICIENCY)
TYPE OF DECISION:	COUNCIL
FREEDOM OF INFORMATION/STATUS:	The report is for publication
SUMMARY:	<p>The report sets out the suggested Strategy for 2013/14 in respect of the following aspects of the Treasury Management function. It is based upon the Treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The Strategy covers:</p> <ul style="list-style-type: none"> • treasury limits in force which will limit the treasury risk and activities of the Council; • prudential and treasury indicators; • the current treasury position; • prospects for interest rates; • the borrowing strategy; • the borrowing requirement;

	<ul style="list-style-type: none"> • debt rescheduling; • the investment strategy; • the minimum revenue provision policy; <p>The primary objective of the Council's treasury management function will continue to be the minimisation of financing costs whilst ensuring the stability of the authority's long term financial position by borrowing at the lowest rates of interest and by investing surplus cash to earn maximum interest, all at an acceptable level of risk.</p> <p>The overall strategy for 2013/14 will be to finance capital expenditure by running down cash/investment balances and using short term temporary borrowing rather than more expensive longer term loans. The taking out of longer term loans (1 to 10 years) to finance capital spending will only then be considered if required by the Council's underlying cash flow needs. With the reduction of cash balances the level of short term investments will fall. Given that investment returns are likely to remain low (say) 0.70% for the financial year 2013/14, then savings will be made from running down investments rather than taking out more expensive long term loans.</p>
<p>OPTIONS & RECOMMENDED OPTION</p>	<p>It is recommended that Overview and Scrutiny Committee notes the report;</p> <p>It is recommended that Cabinet approves, for onward submission to Council, the:</p> <ul style="list-style-type: none"> • Prudential Indicators forecast for 3 years • Treasury Management Strategy for 2013/14 • Minimum Revenue Provision Policy for 2013/14 • Schemes of Delegation and Responsibility attached at Appendices 2 and 6 <p>It is recommended that Council approves the report.</p> <p>Reasons for the Decision:</p> <p>It is a requirement of the CIPFA Code that the Council receives an annual treasury management strategy report.</p>
<p>IMPLICATIONS:</p>	
<p>Corporate Aims/Policy Framework:</p>	<p>Do the proposals accord with the Policy Framework? Yes</p>
<p>Statement by the S151 Officer:</p>	<p>Treasury Management is an integral part</p>

Financial Implications and Risk Considerations:	of the Council's financial framework and it is essential that the correct strategy is adopted in order to ensure that best value is obtained from the Council's resources and that assets are safeguarded.
Statement by Executive Director of Resources:	There are no additional resource implications.
Equality/Diversity implications:	No
Considered by Monitoring Officer:	Yes
Wards Affected:	All
Scrutiny Interest:	Overview & Scrutiny Committee

TRACKING/PROCESS

EXECUTIVE DIRECTOR: Mike Owen

Chief Executive/ Senior Leadership Team	Cabinet Member/Chair	Ward Members	Partners
Yes	Finance & Resources		
Scrutiny Committee		Committee	Council
Overview & Scrutiny 13/2/13		Cabinet 20/2/13	Council 20/2/13

1.0 BACKGROUND

- 1.1 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.
- 1.2 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.
- 1.3 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."

1.4 Reporting requirements

- 1.4.1 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) – the first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

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

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

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

1.5 In Year Monitoring Arrangements

1.5.1 Budget monitoring reports are produced on a monthly basis, together with quarterly reporting to Cabinet and the Overview and Scrutiny Committee.

1.5.2 In 2012/13 the average rate of return on investments is 1.66%.

1.6 Treasury Management Strategy for 2013/14

1.6.1 The strategy for 2013/14 covers two main areas:

Capital issues

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

Treasury management issues

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

1.6.2 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.

1.7 Treasury Management consultants

1.7.1 The Council uses Sector as its external treasury management advisors.

1.7.2 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.

1.7.3 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.

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2013/14 – 2015/16

2.1 The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans.

2.2 Capital expenditure

2.2.1 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure	2011/12 Actual £'000	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Non HRA	21,558	19,591	8,855	4,020	2,771
HRA	5,016	7,847	7,628	7,895	8,171
Housing Reform Settlement	78,253	0	0	0	0
Total	104,827	27,438	16,483	11,915	10,942

2.3 The Council's borrowing need (the Capital Financing Requirement)

2.3.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

2.3.2 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

2.3.3 The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

Capital Financing Requirement	2011/12 Actual £'000	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
CFR - Non HRA	129,412	133,335	129,764	124,552	119,549
CFR – HRA existing	40,531	40,107	40,107	40,107	40,107
Housing Reform Settlement	78,253	78,253	78,253	78,253	78,253
Total CFR	248,196	251,695	248,124	242,912	237,909

2.4 Minimum revenue provision (MRP) policy statement

2.4.1 The concept of MRP was introduced in 1989 to prescribe the minimum amount which must be charged to the revenue account each year to meet credit liabilities (borrowing and leasing costs).

2.4.2 The Council will follow the same policy in 2013/14 as it did in 2012/13. Accordingly it is recommended that the:

- Regulatory method for calculating MRP be used for supported borrowing
- Asset Life method of calculating repayment provision be used for unsupported borrowing

2.4.3 It is to be noted that the above policy resulted in MRP savings of £51,000 in 2010/11, £72,000 in 2011/12, and is expected to generate further savings in 2012/13 and 2013/14.

2.5 Affordability prudential indicators

2.5.1 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

2.6 Ratio of financing costs to net revenue stream.

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

%	2011/12 Actual £'000	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Non HRA	2.47%	3.00	2.95%	2.89	2.83%
HRA	5.82%	15.44%	14.81%	14.18%	13.61%

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

2.7 Incremental impact of capital investment decisions on Council Tax

2.7.1 This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

2.7.2 Incremental impact of capital investment decisions on the band D council tax:

	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Council tax – band D	£1.15	£0.85	£0.35	£0.35

2.8 Estimates of the incremental impact of capital investment decisions on housing rent levels.

2.8.1 Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

2.8.2 Incremental impact of capital investment decisions on housing rent levels:

	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Weekly housing rent levels	£0	£0	£0	£0

3.0 BORROWING

3.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the 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.

3.2 Current portfolio position

3.2.1 To assist Members in agreeing a strategy for 2013/14 the Council's current treasury portfolio position (at nominal value) is detailed below:

	31 st March 2012			Forecast 31 st March 2013		
	Principal		Avg. Rate	Principal		Avg. Rate
	£'000	£'000		£'000	£'000	
Fixed rate						
PWLB Bury	161,362			161,362		
PWLB Airport	5,256			4,829		
Market Bury	39,000	205,618		39,000	205,191	
Variable rate funding						
PWLB Bury	0			0		
Market Bury	0	0		0	0	
Temporary Loans / Bonds	3	3		3,003	3,003	
Total Debt		205,621	4.21%		208,194	4.15%
Total Investments		23,881	1.39%		25,000	1.66%

3.2.2 The forecast accumulated capital financing requirement at the end of 2012/13 is £256.4m. The forecast borrowing at the end of 2012/13 is £208.2m meaning that the Authority is under borrowed by £48.2m.

3.2.3 The investment portfolio after the Capital Programme has been spent during 2012/13 is estimated to be around £25m. In preference to taking out long term borrowing, the Authority is taking temporary loans and running down investments to finance capital expenditure because investment returns are low at the present time. The estimated rate of interest on investments for 2012/13 is 1.66%.

3.3 Treasury Indicators: limits to borrowing activity

3.3.1 **The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational Boundary	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Borrowing	189,400	189,400	189,400	189,400
Other long term liabilities	7,800	7,300	6,800	6,300
HRA Settlement	79,300	79,300	79,300	79,300
Total	276,500	276,000	275,500	275,000

3.3.2 **The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a

limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

Authorised Limit	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Borrowing	214,500	214,500	214,500	214,500
Other long term liabilities	7,800	7,300	6,800	6,300
HRA Settlement	79,300	79,300	79,300	79,300
Total	301,600	301,100	300,600	300,100

3.4 Prospects for interest rates

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

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

3.4.2 The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income, general malaise about the economy and employment fears.

3.4.3 The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Eurozone so the difficulties in this area are likely to continue to hinder UK growth. The US, the main world economy, faces similar debt problems to the UK, although it has managed to resolve the fiscal cliff now that the Presidential elections are out of the way. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth and is likely to see the UK deficit reduction plans slip.

3.4.4 This challenging and uncertain economic outlook has several key treasury management implications:

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2013/14 and beyond;
- Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

3.5 Borrowing strategy

3.5.1 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.

3.5.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2013/14 treasury operations. The Assistant Director of Resources (Finance and Efficiency) 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 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 were still relatively cheap.*

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

3.6 Treasury management limits on activity

3.6.1 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Interest rate exposures	2013/14 Upper	2014/15 Upper	2015/16 Upper
Limits on fixed interest rate exposure net principal re fixed rate borrowing / investments	140%	140%	£140%
Limits on variable interest rate exposure net principal re fixed rate borrowing / investments	-40%	-40%	-40%
Maturity structure of fixed interest rate borrowing 2013/14			
		Upper	Lower
Under 12 months		40%	0%
12 months and within 24 months		35%	0%
24 months and within 5 years		40%	0%
5 years and within 10 years		50%	0%
10 years and above		90%	30%

3.7 Policy on borrowing in advance of need

3.7.1 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.

3.7.2 In determining whether borrowing will be undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets, have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

3.8 Borrowing Requirement

3.8.1 Based on a current forecast for the capital financing requirement plus the replacement of existing debt, less the minimum revenue provision (MRP) and the voluntary revenue provision (VRP), the net borrowing requirement for the current year and the next three years is estimated to be as follows.

	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Alternative Financing	76,600	3,444	0	0
Replacement borrowing	7,500	14,000	11,700	12,693

Borrowing Requirement	84,100	22,103	11,700	12,693
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3.8.2 Alternative financing is a combination of running down cash balances and investments and temporary borrowing.

3.8.3 The increase in the capital financing requirement (CFR) for 2011/12 was £76.600m and borrowing/funding for this amount would normally take place in 2012/13. The increase in the CFR for 2012/13 is estimated at £3.444m and borrowing/funding for this amount would normally take place in 2013/14. The plan is to use a combination of internal borrowing (i.e. running down cash balances/investments) and temporary borrowing to finance these items, and to only use more long term borrowing (1 to 10 years) if required by the Council's underlying cash flow needs.

3.8.4 The overall effect of the finance costs on the General Fund for the next three years is detailed in the Affordable Borrowing Limit prudential indicator. This ultimately shows the effect of the proposed capital investment decision on the council tax compared to a situation with the same level of capital investment as occurred in the previous year. Changes in the capital investment decision affects the movement in new borrowing for capital purposes, resulting in a change in the finance costs which impacts council tax.

Affordable Borrowing Limit	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Increase in Council tax	£1.15	£0.85	£0.35

3.9 Debt rescheduling

3.9.1 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).

3.9.2 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).

3.9.3 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.

3.9.4 All rescheduling will be reported to the Council, at the earliest meeting following its action.

4.0 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

- 4.1.1 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.
- 4.1.2 The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The Council recognises that the borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.
- 4.1.3 The guidance primarily focuses on high security and investing with bodies with high credit ratings. However, this focus only deals with credit risk i.e. the potential for default by a counterparty, as occurred with BCCI in 1991, which could result in the loss of the principal sum invested.
- 4.1.4 However, this approach does not deal with market risk i.e. an adverse movement in interest rates which, with some investment products, could lead to a diminution of the maturity value below that of the original principal sum invested. There is for example, potential for this to occur with investments in pooled investments i.e. collective investment schemes where an investment of cash is translated into the purchase of units in the fund. The value of these units is NOT guaranteed to remain unchanged between the date of investment and the maturity date. However, pooled vehicles do use rigorous methods to control their risk exposure and so consequently, they do have high credit ratings. But higher rates of return can usually only be achieved by taking on greater exposure to risk.
- 4.1.5 Therefore the categories of investments listed below are split between Specified and Non-Specified investments dependent on the level of credit and market risk the authority believes is associated with the investment categories.
- 4.1.6 Specified investments are identified by the Guidance as requiring "minimal procedural formalities". Specified investments are therefore categorised of investment which are more risk averse.
- 4.1.7 The spirit of the guidance is that investment products which take on greater risk and therefore should be subject to greater scrutiny, should be subject to more rigorous justification and agreement of their use in the Annual Investment Strategy and so should fall into the non specified category; this would apply regardless of whether they are under one year investments and have high credit ratings.

4.2 Specified Investments:

- 4.2.1 All such investments will be sterling denominated, with maturities up to a maximum of 1 year, meeting the minimum 'high' rating criteria where applicable. The table below details the different investment categories available.

Investment Category	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	N/A	In-house
Term deposits – other LAs	N/A	In-house
Term deposits – banks and building societies	Short-term F1, Long-term A-, Individual C- or BB+, Support 1,2,3 or equivalent	In-house
Fixed term Deposits with variable rate & variable maturities:-		

1. Callable Deposits	Short-term F1, Long-term A-, Individual C- or BB+, Support 1,2,3 or equivalent	In-house
Certificates of deposits issued by banks and building societies	Short-term F1, Long-term A-, Individual C- or BB+, Support 1,2,3 or equivalent	In-house buy & hold after advice from Sector Treasury Services
UK Government Gilts	AAA	In-house buy & hold after advice from Sector Treasury Services
Bonds issued by multilateral development banks	AAA	In-house buy & hold after advice from Sector Treasury Services
Bonds issued by a financial institution which is guaranteed by the UK government	AAA	In-house buy & hold after advice from Sector Treasury Services
Sovereign bond issues (i.e. other than the UK govt)	AAA	In-house buy & hold after advice from Sector Treasury Services
Treasury Bills	Govt-backed	In-house buy & hold after advice from Sector Treasury Services
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):		
Money Market Funds	AAA	In-house

4.3 Non-Specified Investments:

4.3.1 A maximum of 100% can be held in aggregate in non-specified investments during the year. Non-specified investments for this local authority are surplus funds

- placed with counterparties for less than one year but do not meet the high credit rating described in specified investments

- placed in investment structures or pooled investments that have a slightly higher level of risk
- that are invested for periods of greater than 1 year

4.3.2 The limit for investments to be placed for more than one year is 20%. The table below shows the limits given to the different investment categories;

Non-Specified Investments Less than 1 year				
	Minimum Credit Criteria	Use	Max % of total investments	Max Maturity Period
Term deposits – banks and building societies – with lower ratings than specified investments; any maturity not greater than 1 year	Short term F2, Long Term A, Individual BB+, Support 1,2,3	In house	100%	Not greater than 1 year
Collective Investment Schemes structured as Open-Ended Investment Companies (OEICs)				
Short Term Funds	Short term F1, Long Term A-	In house	10%	Not greater than 1 year

Non-Specified Investments in excess of 1 year				
	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – other LA's	N/A	In-house	10%	5 years
Term deposits – banks and building societies	Short-term F1, Long-term A-, Individual BB+, Support 1,2,3	In-house	10%	5 years
Fixed term Deposits with variable rate & variable maturities :-				
Callable Deposits	Short-term F1, Long-term A-, Individual BB+, Support 1,2,3 or equivalent	In-house	10%	5 years
Certificates of deposits issued by banks and building societies	Short-term F1, Long-term A-, Individual BB+, Support 1,2,3	Fund managers	10%	5 years
UK Government Gilts	AAA	Fund Managers	10%	5 years
Bonds issued by multilateral development banks	AAA	In-house on a 'buy-and-hold' basis. Also for use	10%	5 years

		by fund managers		
Bonds issued by a financial institution which is guaranteed by the UK government	AAA / government guaranteed	In-house on a 'buy-and-hold' basis. Also for use by fund managers	10%	5 years
Sovereign bond issues (i.e. other than the UK govt) with maturities in excess of 1 year	AAA	Fund Managers	10%	5 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):-				
1. Bond Funds	Short-term F1, Long-term A-	In-house	10%	5 years
2. Gilt Funds (UK Government Bonds)	Short-term F1, Long-term A-	In-house	10%	5 years

4.3.3 In addition to listing the Investment Categories that the Council can use overall, it is necessary to determine detailed limits for investment categories that are used on a daily basis for short term investments. This incorporates the high credit criteria detailed for specified investments and also the credit criteria detailed for non-specified investments.

4.3.4 The Council uses Fitch ratings to derive its criteria. Where a counter-party does not have a Fitch rating, the equivalent Moody's or Standard and Poor's rating will be used. All credit ratings will be monitored monthly. The Council is alerted to changes in Fitch ratings through its use of the Sector Creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. If a Counterparty / investment scheme meets the Council's minimum criteria, consideration will be given to its inclusion for investment purpose.

4.4 Creditworthiness policy

4.4.1 This Council applies the creditworthiness service provided by Sector. 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.

4.4.2 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:

- Purple 2 years
- Blue 1 year (nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No colour not to be used

4.4.3 All credit ratings will be monitored daily and weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap 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.

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

4.5 Country limits

4.5.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 3. This list will be added to, or deducted from, by offices should ratings change in accordance with this policy.

4.6 Investment Strategy

4.6.1 **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).

4.6.2 **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 1 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2012/13 0.50%
- 2013/14 0.50%
- 2014/15 0.75%
- 2015/16 1.75%

4.6.3 There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.

4.6.4 The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next three years are as follows:

2013/14	0.50%
2014/15	0.60%
2015/16	1.50%

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

Maximum principal sums invested > 364 days			
£m	2013/14	2014/15	2015/16
Principal sums invested > 364 days	£10m	£10m	£10m

4.7 End of year investment report

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

5.0 EQUALITY & DIVERSITY

- 5.1 An initial assessment has been undertaken and it is concluded that there will be no negative impact from this report.

COUNCILLOR TONY ISHERWOOD CABINET MEMBER FOR FINANCE AND RESOURCES

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APPENDIX 1: Interest Rate Forecasts 2013 – 2016

Sector's Interest Rate View														
	Now	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.39%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%	1.40%	1.70%
6 Month LIBID	0.54%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%	1.60%	1.90%
12 Month LIBID	0.88%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%	1.80%	2.10%
5yr PW IB Rate	1.85%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
10yr PW IB Rate	2.87%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
25yr PW IB Rate	4.02%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
50yr PW IB Rate	4.15%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
Bank Rate														
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PW IB Rate														
Sector's View	1.85%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
UBS	1.85%	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.85%	1.55%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	-	-	-	-	-
10yr PW IB Rate														
Sector's View	2.87%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
UBS	2.87%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	-	-	-	-	-
Capital Economics	2.87%	2.55%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	-	-
25yr PW IB Rate														
Sector's View	4.02%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
UBS	4.02%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	-	-	-	-	-
Capital Economics	4.02%	3.70%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-	-	-	-	-
50yr PW IB Rate														
Sector's View	4.15%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
UBS	4.15%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	-	-	-	-	-
Capital Economics	4.15%	4.00%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

APPENDIX 2: Economic Background

The Global economy

The Eurozone debt crisis has continued to cast a pall over the world economy and has depressed growth in most countries. This has impacted the UK economy which is unlikely to grow significantly in 2012 and is creating a major headwind for recovery in 2013. Quarter 2 of 2012 was the third quarter of contraction in the economy; this recession is the worst and slowest recovery of any of the five recessions since 1930. A return to growth @ 1% in quarter 3 proved nothing more than a washing out of the dip in the previous quarter before a return to negative growth in quarter 4.

The **Eurozone sovereign debt crisis** has abated somewhat following the ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bailout. The immediate target for this statement was Spain which continues to prevaricate on making such a request and so surrendering its national sovereignty to IMF supervision. However, the situation in Greece is heading towards a crunch point as the Eurozone imminently faces up to having to relax the time frame for Greece reducing its total debt level below 120% of GDP and providing yet more financial support to enable it to do that. Many commentators still view a Greek exit from the Euro as inevitable as total debt now looks likely to reach 190% of GDP i.e. unsustainably high. The question remains as to how much damage a Greek exit would do and whether contagion would spread to cause Portugal and Ireland to also leave the Euro, though 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 since this ECB action and recent Eurozone renewed commitment to support Greece and to keep the Eurozone intact. However, the foundations to this "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse.

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

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

The UK economy

The Government's austerity measures, aimed at getting the public sector deficit into order over the next four years, now look as if they will fail to achieve their objectives within the original planned timeframe. Achieving this target is dependent on the UK economy growing at a reasonable pace but recession in the Eurozone, our biggest trading partner, has depressed growth whilst tax receipts have not kept pace with additional welfare benefit payments. It will be important for the Government to retain investor confidence in UK gilts so there is little room for it to change course other than to move back the timeframe.

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

Economic Growth. Economic growth has basically flat lined since the election of 2010 and, worryingly, the economic forecasts for 2012 and beyond were revised substantially lower in the Bank of England Inflation quarterly report for August 2012 and were then further lowered in the November Report. Quantitative Easing (QE) was increased again by £50bn in July 2012 to a total of £375bn. Many forecasters are expecting the MPC to vote for a further round of QE to stimulate economic activity regardless of any near-term optimism (although at the time of writing this hasn't happened). The announcement in November 2012 that £35bn will be transferred from the Bank of England's Asset Purchase Facility to the Treasury (representing coupon payments to the Bank by the Treasury on gilts held by the Bank) is also effectively a further addition of QE.

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

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

AAA rating. The UK continues to enjoy an AAA sovereign rating. However, the credit rating agencies will be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years. Moody's has stated that it will review the UK's AAA rating in the very near future.

Sector's forward view

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

- the potential for the Eurozone to withdraw support for Greece at some point if the costs of such support escalate were to become prohibitive, so causing a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
- inter government agreement on how to deal with the overall Eurozone debt crisis could fragment; the impact of the Eurozone crisis on financial markets and the banking sector;

- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to manufactured goods;
- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that are unlikely to be achieved;
- the risk of the UK's main trading partners, in particular the EU and US, falling into recession ;
- stimulus packages failing to stimulate growth;
- elections due in Germany in 2013;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.
- the potential for action to curtail the Iranian nuclear programme
- the situation in Syria deteriorating and impacting other countries in the Middle East

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

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

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

- UK inflation being significantly higher than in the wider EU and US causing an increase in the inflation premium in gilt yields
- Reversal of QE; this could initially be allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held
- Reversal of Sterling's safe haven status on an improvement in financial stresses in the Eurozone
- Investors reverse de-risking by moving money from government bonds into shares in anticipation of a return to worldwide economic growth
- The possibility of a UK credit rating downgrade (Moody's has stated that it will review the UK's AAA rating at the start of 2013).

APPENDIX 3: Approved countries for investments

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.

AA+

- France
- Hong Kong
- U.S.A.

AA

- Abu Dhabi
- Qatar
- UAE

AA-

- Belgium
- Japan
- Saudi Arabia

APPENDIX 4: DELEGATION AND RESPONSIBILITY

The following personnel are involved on a regular basis in Treasury Management: -

Executive Director of Resources (Mike Owen)	Overall supervision of Treasury Management function and cashflow. Regular reviews of Treasury Management Strategy.
Assistant Director of Resources (Steve Kenyon)	Deputise for the Executive Director of Resources. Direct supervision of Treasury Management function. Assist in reviews of Treasury Management Strategy and monitor performance
Head of Financial Management (Andrew Baldwin)	Deputise for the Executive Director of Resources
Principal Accountant (Management Accountancy) (Jane Bunn)	Manage and undertake day to day Treasury Management Activities in accordance with Treasury Strategy and Policy Statement.
Senior Accountant (Joanne McIntyre)	Deputise for Principal Accountant in her duties as required.
Senior Accountant (Angela Sozansky)	Deputise for Principal Accountant in her duties as required.
Senior Accountancy Assistant (Stephen Blake)	Deputise for Principal Accountant in her duties as required.
Accountancy Assistant (Linda Hughes)	Standby for allocation of short term business via brokers.

Please note that the Council's signatories for treasury management transactions are :-

Mike Owen	Executive Director of Resources
Steve Kenyon	Assistant Director of Resources
Andrew Baldwin	Head of Financial Management
Lewis Magid	Principal Accountant

APPENDIX 5: Treasury management scheme of delegation

(i) Full council

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

(ii) Boards/committees/Council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body/person(s) with responsibility for scrutiny

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

APPENDIX 6: 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.