Agenda Item No. 7

Audit Committee – 6 January 2014

Treasury Management and Investment Strategy 2014/15 Onwards

1. Summary of report

1.1. This report sets out the council's proposed Treasury Management and Investment strategy 2014/15 onwards **(Appendix A).** It is included in the council's Corporate budget plan 2014/15.

2. Recommendations

Audit Committee are asked to:

2.1. Note and endorse the Treasury Management and Investment strategy 2014/15 onwards **(Appendix A).**

2.2. Note that any changes required as a result of the Autumn Statement or Local Government Finance Settlement will be made prior to the final submission to Council for approval of the Strategy.

James T Walsh – Assistant Director, Finance
(Chief Finance Officer)
19th December 2013

3. Background information

3.1. Treasury Management is defined 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."

3.2. **Appendix A** is the proposed Treasury Management and Investment Strategy 2014/15 onwards which forms part of the council budget setting process presented to Cabinet and Council.

3.3. Members consider the Strategy each year as a requirement of the CIPFA Code of Practice on Treasury Management in the Public Services; the updated version (revised November 2010) which Cabinet formally adopted on 22 March 2010.

3.4. The proposed strategy for 2014/15 onwards supports the council's 2014/15 Corporate budget plan and in particular the financing of the capital programme. It is based upon the treasury officers' view on interest rates, supplemented with leading market forecasts provided by the council's treasury adviser, Capita Asset Services.

The Strategy covers:

Annex 1
- Treasury limits in force, which will limit the treasury risk and activities of the council
- The current treasury position
- The borrowing requirement
- Debt rescheduling and debt repayment
- Interest rate prospects
- Economic background

Annex 2
- Borrowing Objectives
- Investment Objectives
- Creditworthiness policy
- Annual Minimum Revenue Provision (MRP) Statement 2014/15 onwards

Annex 3
- National and Local Prudential and Treasury Indicators

Annex 4
- Economic Outlook and Interest Rate Forecast
- Policy on use of external service providers

Annex 5
- Glossary of Terms (includes explanation of Treasury Management technical terms)

3.5. Borrowing and investment objectives have been updated to take into account the expected continuation of low interest rates. There are no current plans to take on additional borrowing. This is reviewed continually and may change if economic circumstances change, for example if there are signs that interest rates are going to rise steeply.

4. Resource and Legal considerations

4.1 Financial

The Treasury Management and Investment Strategy is a key document for the operation, review and performance assessment of treasury management and is reviewed annually. It forms part of the council's financial framework and supports delivery of the medium term financial strategy.

4.2 **Legal**

The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original Treasury Management Code in 1992 and further revised Codes in 2002 and 2010.

5. Risk and performance management issues

5.1 **Risk**

Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. The Treasury Management Policies approved by Audit Committee on 11 November 2013 provide the framework of governance and control in which the strategy operates.

5.2 **Performance**

The treasury management function participates in a local and national benchmarking group which compares Walsall council's treasury management performance with those of other councils. Performance is regularly reviewed by the treasury management panel. The treasury management annual report has been distributed to all councillors and will be used for member training.

6. Equality implications

6.1 None directly relating to this report.

7. Consultation

7.1 The report has been approved by the finance treasury management panel, an internal governance arrangement comprising the Chief Finance Officer, Head of Finance and Treasury Financial Administration and Systems Manager.

8.0 **Background papers**

- Various financial working papers
- Annual review of treasury management policy statement – Audit 11.11.13
- Financial Plan 2014/15 to 2018/19 – Draft revenue budget and capital programme for consultation - Cabinet 23.10.13

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APPENDIX A

Treasury Management and Investment Strategy for 2014/15 Onwards

Members consider the Treasury Management and Investment Strategy each year as a requirement of the CIPFA Code of Practice on Treasury Management in the Public Services; the updated version (revised November 2010) of which Cabinet formally adopted on 22 March 2010.

The suggested Strategy for 2014/15 onwards 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, Sector.

The strategy covers:

Annex 1
- Treasury limits in force, which will limit the treasury risk and activities of the council
- The current treasury position
- The borrowing requirement
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- Interest rate prospects
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Annex 2
- Borrowing Objectives
- Investment Objectives
- Creditworthiness policy
- Annual Minimum Revenue Provision (MRP) Statement 2013/14 onwards

Annex 3
- National and Local Prudential and Treasury Indicators

Annex 4
- Economic Outlook and Interest Rate Forecast
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Annex 5
- Glossary of Terms (includes explanation of Treasury Management technical terms)

ANNEX 1 - Treasury Limits and Borrowing Limits

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

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 levels is 'acceptable'.

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 **Annex 3** prudential indicator 5. The Authorised Limit is the council's capital financing requirement (which is a measure of the council's need to finance cumulative capital expenditure from borrowing) plus a contingency for unexpected cash flows or emergency payments.

The current treasury position

The council is expected to end 2013/14 with a borrowing portfolio of £245m against an asset base of approximately £500m, and short term investments of between £115m and £145m. These will be proactively managed to minimise borrowing costs and maximise investment returns within a robust risk management environment. In 2014/15 estimated annual interest payments are £10.5m and investment interest income is £0.884m. The net budget for capital financing in 2014/15 is £23.1m. The treasury management budget required for the running of the treasury management function for 2014/15 is £0.184m. By having a proactive approach to managing cash flows and investments it is estimated that investment income of £0.371m above the bank base rate will be generated.

The council's treasury portfolio position at 30 November 2013 is comprised of:

Table 1: Borrowing and Investments

	Borrowing £ m	Investments £ m	Net Borrowing £ m
31 March 2013	255.902	Cr 137.380	118.522
30 November 2013	245.902	Cr 127.185	118.717
Change in year	Cr 10.000	10.195	0.195

It shows that the net borrowing position is very close to the beginning of the year figure. The lower borrowing balance is due to a scheduled repayment of £10m PWLB borrowing. This repayment has increased the average rate across the council's remaining borrowing from 4.67% to 4.73%. Local indicators L5 and L6 have been updated to reflect this.

The council's treasury portfolio position at 30 November 2013 with forward projections are summarised below in Table 2. It shows the actual external borrowing (the treasury management operations), against the capital borrowing need, operational debt, and highlights any over or under borrowing. It shows that the council's underborrowing position is expected to continue for the medium term.

Table 2: Borrowing Compared to Operational Debt Level			
	2014/15 £ m	**2015/16 £ m**	**2016/17 £ m**
PWLB	106.588	106.621	106.655
Market Loans	122.000	122.000	122.000
Bonds and Temporary Loans	0.840	0.840	0.840
Net Other Local Authority Debt	15.063	14.251	13.356
Total Borrowing	244.491	243.712	242.851
Operational Debt – Prudential Indicator 6	307.527	310.629	308.929
(Under) / Over Borrowing	(63.036)	(66.917)	(66.078)

The borrowing requirement

The council's capital expenditure plans are the key driver of treasury management activity and the need to borrow**.** The output of the capital expenditure plans is reflected in prudential indicators which are designed to assist member overview and confirm capital expenditure plans. The current capital plans which this strategy supports are detailed below in Table 3.

Table 3: Current Capital Programme					
	2012/13 Actual £m	**2013/14 Estimated £m**	**2014/15 Estimated £m**	**2015/16 Estimated £m**	**2016/17 Estimated £m**
Total capital expenditure	**50.828**	**83.203**	**37.610**	**25.750**	**17.100**
Resourced by:					
• Capital receipts	4.625	1.500	1.500	3.310	1.500
• Capital grants	31.563	60.673	23.560	13.990	10.350
• Capital Reserves			6.350	2.520	-
• Revenue	0.156				
• Borrowing	14.484	21.030	6.200	5.930	5.250
Total to be financed	**50.828**	**83.203**	**37.610**	**25.750**	**17.100**

Prudential Indicator 4 is the council's capital financing requirement (CFR). It is a measure of the council's underlying borrowing need. It is increased by the borrowing required to support the capital programme. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) which is a statutory annual revenue charge that reduces the borrowing need in line with each asset's life. The CFR is thus the total historic outstanding capital expenditure which has not yet been paid for from either revenue of capital resources.

The CFR includes other liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the council's borrowing requirement, these types of scheme include a borrowing facility and so the council is not required to separately borrow for these schemes. The council currently has £9.7m of these schemes. The table 4 shows

CFR projections up to 2016/17. It includes a prudent provision for additional borrowing capacity for major strategic projects.

Table 4: Analysis of CFR	2012/13 Actual £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Capital Financing Requirement					
Total CFR	305.908	314.141	317.293	320.394	318.694
Movement in CFR	6.457	8.233	3.152	3.101	Cr 1.700
Movement in CFR represented by					
Net financing need for the year.	14.484	21.030	6.200	5.930	5.250
Less MRP/VRP and other financing movements	Cr 8.027	Cr 12.797	Cr 13.048	Cr 12.829	Cr 11.950
Additional Borrowing Capacity for strategic Projects			10.000	10.000	5.000
Movement in CFR	6.457	8.233	3.152	3.101	Cr 1.700

The MRP policy (see annex 2) details the council's policies for calculating the annual amount charged to revenue for the repayment of debt.

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

Against this background and risks within the economic forecast, caution will be adopted with the 2014/15 treasury operations. The treasury manager will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. For example, 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 additional borrowing will be taken whilst interest rates are still lower than they will be in the next few years.

Any decisions will be reported to the Treasury Management Panel (TMP) at the earliest possible opportunity.

Debt rescheduling and debt repayment

As short term rates on investments are likely to be lower than rates paid on current debt, consideration will also be given to identify if there is any potential left for making savings by running down investment balances to repay debt prematurely. However, these savings need to be considered in the light of the size of premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a shortening of the council's maturity profile. Prudential indicator 12 has been amended to enable this. All rescheduling will be undertaken in accordance with TMP 5 and reported to the TMP at the next available meeting following its action.

Critical to the consideration of the debt rescheduling and debt repayment is the outlook for interest rates.

Prospects for interest rates

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. Table 5 gives a central view.

Table 5 : Forward Interest Rate Projections				
Annual Average %	**Bank Rate %**	**PWLB Borrowing Rates % (including certainty rate adjustment)**		
		5 year	**25 year**	**50 year**
Dec 2013	0.50	2.50	4.40	4.40
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

A consequence of this continued low interest rate environment is that the targets for investment returns for 2014/15 and 2015/16 have been reduced.

Economic Background to the above

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest in recent history. However, growth has rebounded during 2013 to surpass all expectations. Growth prospects remain strong for 2014, not only in the UK economy as a whole, but in all three main sectors: services, manufacturing and construction. One downside 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. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth. There are, therefore, concerns that a UK recovery currently based mainly on consumer spending and the housing market, may not endure much beyond 2014. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

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

- Although Eurozone concerns have subsided in 2013, Eurozone sovereign debt difficulties have not gone away and there are major concerns as to how these will be managed over the next few years as levels of government debt to GDP ratios, in some countries, continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated.This continues to suggest the use of higher quality counterparties for shorter time periods.

- Investment returns are likely to remain relatively low during 2014/15 and beyond.

- Borrowing interest rates have risen during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served us 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.

ANNEX 2: TREASURY MANAGEMENT AND INVESTMENT STRATEGIES - 2014/15 ONWARDS

Walsall council has a successful track record of effective treasury management, securing low cost borrowing to fund capital investment. Our aim is to continue to do so within the requirements of the prevailing policies and codes of practice.

In order to achieve our aim:

1. All borrowing and/or investment activity will be carried out in accordance with the approved treasury management strategy and treasury policy statements and within approved prudential indicators, having the highest regard for prudence, affordability and sustainability in the longer term.

2. Appropriate use will be made of the Code for Capital Investment within approved prudential indicators and subject to medium term affordability.

Specific objectives have been developed to measure and guide borrowing and investment activities. These are monitored by local indicators (**Annex 3**).

BORROWING OBJECTIVES

Our borrowing objectives are:

- To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio
- To manage the council's debt maturity profile, ensuring no single future year has a disproportionate level of repayments
- To maintain a view on current and possible future interest rate movements and borrow accordingly
- To monitor and review the balance between fixed and variable rate loans against the background of interest rate levels and prudential indicators.

Specific Borrowing Objectives

In response to the context outlined in **Annex 4** the following changes have been made:

- **L1**. Full compliance with the Prudential Code - **No Change.**
- **L2**. Average maturity date between 15 and 25 years - **No Change.**
- **L3** Net borrowing costs to be less than **11.5%** of council tax requirement and **6.5%** of council tax requirement plus NNDR contribution. – **No Change**.
- **L4** Actual debt as a proportion of operational debt range is maintained in the range 75%- 90% - **No Change,**
- **L5.** Average interest rate for internally managed debt will be equal to or less than 4.6%**– Increased from 4.52% - Due to payback of £10m PWLB this is considered a more realistic target.**

- **L6.** Average interest rate for total debt (including other local authority debt) will be equal to or less than 4.73%. **– Increased from 4.63% - Due to payback of £10m PWLB this is considered a more realistic target.**
- **L7.** The gearing effect on capital financing estimates of 1% increase in interest rates increase must not be greater than 5% - **No change**

INVESTMENT OBJECTIVES

The general policy objective for this council is the prudent investment of its treasury balances;

- The council's investment priorities are:
    - The security of capital and
    - Liquidity of its investments.
- All investments will be in sterling
- The council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity.

Specific Investment Objectives

- **L8**. Average interest rate received on STI Versus 7 day Libid rate – 0.5% - **No Change**
- **L9.** Average interest rate received on:
    - (a) At call investments – **0.4%** - **Changed from 0.5% to reflect market conditions.**
    - (b) Short term investments – **0.8%** - **Changed from 0.9% to reflect market conditions.**
    - (c) Long term investments – **1.75%** - **Changed from 2.0% to reflect market conditions.**
- L10 Average rate on at call and short term investments will be equal to or greater than **0.7%** - **Changed from 0.8% due to market conditions**.
- L11. Average rate on all investments will be equal to or greater than 0.9**% - Changed from 1.0% due to expected market conditions**
- L12 % daily bank balances within a target range of 98% **- No Change**

CREDITWORTHINESS POLICY

Approved Organisations for Investments

Only organisations that are eligible to receive investments from local authorities may be used. The council's credit worthiness policy was reviewed and approved by Audit Committee on 11 November 2013.

The Monitoring of Investment Counterparties

The credit rating of counterparties will be monitored regularly. The council receives credit rating information from Capita Asset Services as and when ratings change and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list by the treasury manager, and if required new counterparties which meet the criteria will be added to the list.

ANNUAL MRP STATEMENT 2014/15 onwards

Under the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2010, local authorities have a duty to produce an annual statement on its policy for making a minimum revenue provision (MRP).

For the financial years 2014/15 onwards the authority will be adopting the following policies in determining the MRP:

1. For any capital expenditure carried out prior to 31 March 2008 the authority will be adopting the regulatory method. This is where the MRP will be 4% of the opening capital financing requirement (CFR) (which has been adjusted as per the 2003 regulations).

2. For any capital expenditure carried out after 1 April 2008 being financed by unsupported borrowing the authority will be adopting the asset life method (option 3). This is where MRP will be based on the capital expenditure divided by a determined asset life or profile of benefits to give annual instalments.

3. For any capital expenditure carried out after 1 April 2008 being financed by Government supported funding the authority will again be adopting the regulatory method. Where the authority considers the capital expenditure to have added significantly to the lifespan of the asset, we will set aside funds for repayment in line with the appropriate life span of the asset type.

4. The authority will treat the asset life as commencing in the year in which the asset first becomes operationally available. Noting that in accordance with the regulations the authority may postpone the beginning of the associated MRP until the financial year following the one in which the asset becomes operational, there will be an annual adjustment for Assets Under Construction.

5. In all years the CFR for the purposes of the MRP calculation will be adjusted for other local authority transferred debt.

The Regulatory Method is the calculation of MRP under the previous regulations. When MRP was set at a uniform rate of 4% of the adjusted Capital Financing Requirement. (CFR) on a reducing balance method (which in effect meant that MRP charges would stretch into infinity. This historic approach must continue for all capital expenditure incurred in years before the start of this capital financing regulations 2008.

Finance Leases

In accordance with legislation the council will make a MRP for finance leases equivalent to the principal payment contained with the lease terms.

ANNEX 3 – CAPITAL PRUDENTIAL INDICATORS FOR 2014/15, 2015/16 & 2016/17

The council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators which are designed to assist member overview and confirm capital expenditure plans.

National and local indicators that will be monitored are detailed below. Their aim is to ensure the three principles contained within the prudential code are complied with, i.e. affordability, prudence and sustainability.

National Prudential Indicators

Table 1 details the proposed national prudential indicators for Walsall from 2014/15 to 2016/17. More details on prudential indicators 11 and 12 are shown in table 2.

Table 1: National Prudential Indicators 2014/15 to 2016/17				
No.	**Indicator**	**2014/15**	**2015/16**	**2016/17**
PCI 1	**Total capital expenditure**	£ m 37.610	£ m 25.750	£ m 17.100
Reduces in later years due to uncertainty on the level of future grants and other resources.				
PCI 2	**Estimates of the ratio of financing costs to the net revenue stream**	10.8%	10.8%	10.8%
Net revenue stream is defined as the council tax support plus the NNDR contribution, Formula Grant. This indicator is supplemented by Local Indicator (L3).				
PCI 3	**Estimates of the council tax that would result from the expenditure plans.**	£9.51	£9.09	£8.05
This is a notional amount indicating the amount of council tax band D that is affected by the proposed capital programme recommended in the budget report compared to existing approved commitments and current plans.				
PCI 4	**Estimates of capital financing requirement.**	£ m 317.293	£ m 320.394	£ m 318.694
This represents the underlying level of borrowing needed to finance historic and future capital expenditure. To ensure that net borrowing will only fund capital, except in the short term, net external borrowing should not exceed the total capital financing requirement (CFR) in the preceding year plus estimated capital financing needs for the current and next two years. Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases 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. The council currently has £10.4m of such schemes within the CFR.				

No.	Indicator	2014/15	2015/16	2016/17
PCI 5	**Authorised limit for external debt.**	£ m 349.022	£ m 352.433	£ m 350.564
The council may not breach the limit it sets, so it is important to allow prudent room for uncertain cash flow movements and borrowing in advance of future need.				
PCI 6	**Operational boundary for external debt.**	£ m 307.527	£ m 310.629	£ m 308.929
This has been set at the level of the capital financing requirement less the CFR items relating PFI and finance leases.				
PCI 7	**Net Borrowing exceeds Capital Financing Requirement**	**No**	**No**	**No**
The CFR represents the underlying level of borrowing needed to finance historic capital expenditure. Actual net borrowing should be lower than this because of strong positive cash flow and balances. It would be a cause for concern if net borrowing exceeded CFR.				
PCI 8	**Compliance with CIPFA Code of Practice for TM in the Public Services.**	**Yes**	**Yes**	**Yes**
To ensure that treasury management activity is carried out within best professional practice**.**				
PCI 9	**Upper limits on fixed interest rate exposures.**	**95%**	**95%**	**95%**
The council cannot control interest rates, but a relatively high degree of interest cost stability can be achieved by limiting its exposure to variable rates and by managing the long-term debt maturity profile so that not too much fixed rate debt will mature in any year.				
PCI 10	**Upper limits on variable interest rate exposures: 3.**	**45%**	**45%**	**45%**
See comment under PCI 9.				
PCI 11	**Lower limits for the maturity structure of borrowings: 4.**		**See Table 2**	
Stability can also be managed by the long-term debt maturity profile so that not too much fixed rate debt will mature in any year.				
PCI 12	**Upper limits for the maturity structure of borrowings:**		**See Table 2**	
See comment under PCI 9.				
PCI 13	**Upper limit for principal sums invested for periods longer than 364 days.**	**£25,000,000**	**£25,000,000**	**£25,000,000**
The council is at risk when lending temporarily surplus cash. The risk is limited by investing surplus cash in specified investments and by applying lending limits and high credit worthiness. These are kept under constant review.				

Table 2 - Prudential Indicators: Additional Information	2014/15	2015/16	2016/17
PCI 11. Lower limits for the maturity structure of borrowings:			
- Under 12 Months	0%	0%	0%
- 12 months and within 24 months	0%	0%	0%
- 24 months and within 5 years	0%	0%	0%
- 5 years and within 10 years	10%	10%	10%
- 10 years and above	40%	40%	40%
PCI 12. Upper limits for the maturity structure of borrowings:			
- Under 12 Months	25%	25%	25%
- 12 months and within 24 months	25%	25%	25%
- 24 months and within 5 years	40%	40%	40%
- 5 years and within 10 years	50%	50%	50%
- 10 years and above	85%	85%	85%

Local Prudential Indicators: Table 3 sets out the local PrI's proposed for 2014/15 to 2016/17.

Table 3: Local Prudential Indicators 2014/15 to 2016/17				
No.	**Indicator**	**2014/15**	**2015/16**	**2016/17**
L.1	**Full compliance with Prudential Code**	**Yes**	**Yes**	**Yes**
L.2	**Average length of debt**	**15 to 25 years**	**15 to 25 years**	**15 to 25 years**
This is a maturity measure and ideally should relate to the average lifespan of assets.				
L.3	**a. Net borrowing costs as % of net council tax requirement**	**11.5%**	**11.8%**	**11.8%**
	b. Net borrowing costs as % of council tax requirement and NNDR contribution	**6.5%**	**6.6%**	**6.8%**
This measures the net borrowing costs as % of council tax requirement and is used by CIPFA in their risk benchmarking.				
L.4	**Actual debt versus operational debt within the following range**	**75%-90%**	**75%-90%**	**75%-90%**
This assists the monitoring of the authority's debt position.				
L.5	**Average interest rate of debt excluding OLA less than**	**4.60%**	**4.60%**	**4.60%**
L.6	**Average interest rate of debt including OLA**	**4.73%**	**4.73%**	**4.73%**
The measure should be as low as possible. Other Local Authority debt (OLA) is managed on our behalf by Dudley council.				

No.	Indicator	2014/15	2015/16	2016/17
L.7	**Gearing effect on capital financing costs of 1% increase in interest rate**	**5.0%**	**5.0%**	**5.0%**
This relates risk management principles to the monitoring of the TM strategy. It measures the effect of a change in national interest rates and the effect it may have on the capital financing costs.				
L.8	**Average interest rate received on STI Versus 7 day LIBID rate**	**0.5%**	**0.5%**	**0.5%**
The council aims to be gain interest on surplus funds higher than the 7 day LIBID rate. This measures performance in a changing economic context.				
L.9	**Average interest rate received on:**			
	(a) AT call investments	**0.40%**	**0.40%**	**0.50%**
	(b) Short Term investments	**0.80%**	**0.80%**	**1.00%**
	(c) Long Term investments	**1.75%**	**1.75%**	**2.00%**
L.10	**Average interest rate on all ST investments. (ST and At call)**	**0.7%**	**0.7%**	**0.8%**
A recognised PI for measuring the performance of return on investments.				
L.11	**Average rate on all investments**	**0.9%**	**0.9%**	**1.2%**
As L10 but includes investments longer than 364 days.				
L.12	**% daily bank balances within target range**	**98%**	**98%**	**98%**
This measures how good our daily cash flow prediction is. A figure of 98% indicates a high level of accuracy.				

The monitoring of the indicators supports budget monitoring and is undertaken monthly and considered quarterly by the finance treasury management panel that reports to the finance service’s senior management team including the Chief Finance Officer.

ANNEX 4: ECONOMIC OUTLOOK

THE GLOBAL ECONOMY

The two key areas effecting the UK are the Eurozone and the US economies

The Eurozone (EZ) - The sovereign debt crisis has eased during 2013 which has been a year of comparative calm after the hiatus of the Cyprus bailout in the spring. 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 176% Greece, 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. Many commentators still view a Greek exit from the Euro as inevitable and there are 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. It looks increasingly likely that Slovenia will be the next country to need a bailout.

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.

USA - The economy has managed to return to reasonable growth in quarter 2 of 2013 of 2.5% and 2.8% in quarter 3 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 has continued to provide huge stimulus to the economy through its $85bn per month asset purchases programme of quantitative easing. However, it is expected that this level of support will start to be tapered down early in 2014. It has also pledged not to increase the central rate until unemployment falls to 6.5%; this is probably unlikely to happen until early 2015. Consumer, investor and business confidence levels have 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.

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 stongly 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 the recovery has finally taken hold, but 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.

Growth is expected to be strong for the immediate future. One downside 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. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth.

Forward guidance - The Bank of England issued forward guidance in August which said 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 currently stands at 2.5 million i.e. 7.6 % on the LFS / ILO measure. 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 a significant amount of GDP growth can be accommodated without a major reduction in unemployment.

Credit conditions - While the Bank Rate has remained unchanged at 0.5% and quantitative easing (QE) has remained unchanged at £375bn in 2013, the Funding for Lending Scheme (FLS), aimed at encouraging banks to expand lending to small and medium size enterprises, has been extended. The second phase of Help to Buy aimed at supporting the purchase of second hand properties is now due to start in earnest in January 2014. While there have been concerns that these schemes are creating a bubble in the housing market, the house price increases outside of London and the south-east have been minimal. 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 2.2% in October. It is expected to fall back to reach the 2% target level within 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.

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 await the long expected start of 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, at the time of writing, the political deadlock and infighting between Democrats and Republicans over the budget, and the raising of the debt limit, has only been kicked down the road, rather than resolved. Resolving 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 US Federal Budget and raising of the 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.
- 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.

POLICY ON USE OF EXTERNAL SERVICE PROVIDERS

The council uses **Capita Asset Services (**formerly Sector) as its external treasury management advisers.

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

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

ANNEX 5: GLOSSARY OF TERMS

TERM	DEFINITION
Authorised Limit	Level of debt set by the council that must not be exceeded.
Bond	A government or public company's document undertaking to repay borrowed money usually with a fixed rate of interest.
Borrowing	Obtaining money for temporary use that has to be repaid.
Capital expenditure	Expenditure on major items e.g. land and buildings, which adds to and not merely maintains the value of existing fixed assets.
Capital grants	Specific targeted grants to cover capital expenditure.
Capital receipts	The proceeds from the disposal of land or other assets. Capital receipts can be used to fund new capital expenditure but cannot be used to finance revenue expenditure
Cash flow Management	The management of the authority's receipts and payments to ensure the authority can meet its financial obligations.
Counter party limits	Maximum amount that the council may lend to other institutions will vary according to size and credit rating of other intuitions.
Dividends	Sum to be payable as interest on loan.
ECB	European Central Bank
EU	European Union
GDP	Gross Domestic Product – the total market value of all final goods and services produced in a country in a given year, equal to total consumer investment and government spending, plus the value of exports minus the value of imports.
IMP	International Monetary Fund – an organisation of 187 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.
Investments	The employment of money with the aim of receiving a return.
Libid rate	London Interbank Bid Rate (the rate that banks are willing to borrow from each other)
LOBO	Lenders Option Borrowers Option. A type of loan arrangement.
Liquidity	How easily an asset including investments may be converted to cash.
Long Term Borrowing	Borrowing of money for a term greater than one year.
Long Term Liabilities	Amounts owed by the council greater than 12 months old.
Market convention	The rules and regulations by which all brokers and dealers should abide by. It includes standards of practice and calculation conventions for interest. They are defined in the London Code of Conduct ("The London Code") published by the Bank of England.
MPC	Monetary Policy Committee – group that sets the bank base rate for the Bank of England
Operational Boundary	An indicator of the level day the authority expects during day to day treasury management activities
Other Local Authority Debt	Debt that is owed by one local authority to another local authority.
PCI	Prudential Code Indicator
PFI	Private Finance Initiative
PWLB	Public Works Loan Board, a central government body providing loans to councils.
Prudential Code	A framework of policies and working practices to ensure that local

TERM	DEFINITION
	authorities' capital investment plans are affordable, prudent and sustainable.
Short Term Borrowing	Borrowing of money for a term of up to 364 days.
Supported borrowing	Borrowing where interest and repayment costs are supported by government revenue grants.
Temporary borrowing	Borrowing of money for a term of up to 364 days.
Treasury management	The management of the local authority's cash flows, its borrowings and its investments, the management of associated risks, and the pursuit of the optimum performance or return consistent with those risks.
Treasury Policy Statement	A statement of key policies that an organisation follows in pursuit of effective treasury management, including borrowing limits and strategy.
Variable debt	This is money that has been borrowed at a variable interest rate, and as such is subject to interest rate changes.
Unsupported borrowing	Borrowing taken through the remit of the Prudential Code for which the council will not receive any government funding and will fund from own resources.
Definition of Fitch Primary Credit Rating Scales	
Long Term Ratings A: High credit quality.	A' ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
Short-Term Ratings F1: Highest short-term credit quality.	Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
Definition of Moodys General Credit Rating	
Long-Term Corporate Obligation Ratings - A	Obligations rated A are considered upper-medium grade and are subject to low credit risk.
Short-Term Ratings – P-1	Issuers (or supporting institutions) rated Prime-1 have a superior ability to repay short-term debt obligations.