Agenda item

Audit Committee – 14 January 2013

Annual Review of Treasury Management Policies

1. Summary of report

1.1. This report sets out the council's review of treasury management policies **(Appendix A)** and the 2013/14 Treasury Management and Investment strategy **(Appendix B).**

2. Recommendations

2.1. To approve and recommend to Council, the Treasury Management Policies (**Appendix A**).

2.2. To note and endorse to Council the Treasury Management and Investment strategy 2013/14 onwards **(Appendix B).**

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. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 was adopted by Council on 22 February 2010 and the council fully complies with its requirements.

3.3. Primary requirements of the Code include

- The creation and maintenance of a treasury management policy statement which sets out the policies and objectives of the council's treasury management activities (**Appendix A**)**.**
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions (See Treasury Management Policy TMP 5 page 10).
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this council is the Audit Committee.

3.4 The council has a number of key policies and objectives for borrowing and investment. The policies are laid out in the treasury management policy statement attached as **Appendix A**. The objectives for borrowing are aimed at minimising the revenue cost of borrowing whilst maintaining a balanced loan portfolio. The council's objectives for investments are the prudent investment of council monies with secure institutions at the best possible rates of interest.

3.5 The main updates to the treasury management practices are the criteria of credit ratings around investments which must be met before an investment may be made. This has been reviewed and reflects the current financial and economic climate. See TMP1 Credit and Counter party risk paragraph g. Also the council joining the Local Authority Mortgage Scheme (**LAMS**), which requires the council to deposit funds for a period of five years with a possible extension to seven years to indemnify up to 20% of mortgage deposits for first time buyers.

3.6 **Appendix B** is the draft Treasury Management and Investment strategy 2013/14 onwards which forms part of the council budget setting process and reports being presented to Cabinet and Council.

4. Resource and Legal considerations

4.1 Financial

The treasury management policy statement 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 Code 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. It is recognised that the management of risk is as important as maximisation of performance and it is essential that the council has the right balance of risk and reward when making investment decisions. The treasury management policy statement seeks to manage the risk of adverse fluctuations in interest rates and safeguard the financial interests of the council. Treasury management practice 1 (TMP 1) details the risk management arrangements in place (**Appendix A).**

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 used for member training.

All of the Prudential indicators (PrIs) as at 31.03.12 were complied with.

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, and mid-year review of treasury management activities 2011/12 – Council 07.11.11
- Corporate budget plan and treasury management and investment strategy 2012/13 – Council 24.02.12

Authors
Michael Tomlinson, Treasury Financial Administration and Systems Manager
☎ 01922 652360
✉ tomlinsonm@walsall.gov.uk
Vicky Buckley, Head of Finance
☎ 01922 652470
✉ buckleyv@walsall.gov.uk

APPENDIX A

TREASURY MANAGEMENT POLICY STATEMENT

The CIPFA Code recommends that authorities should:

i. Put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

ii. Policies and practices should make clear that the effective management of risk, having regard to return, is a prime objective of the treasury management activities.

iii. Acknowledge that the pursuit of best value in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, the treasury management policies and practices should reflect this.

In order to do this, the Council should once again adopt a treasury management policy statement as shown below and create and adopt treasury management practices (TMPs):

- A treasury management policy statement, stating policies and objectives of its treasury management activities.
- Suitable TMPs, setting out the manner in which the council will seek to achieve those policies and objectives, prescribing how the council will manage and control those activities.
- The contents of the policy statement and TMPs will follow the recommendations contained in section 6 and 7 of the Code, subject only to amendment where necessary to reflect this council’s particular circumstances.

There are amendments to the responsible posts under delegated powers which reflect changes to the staffing structure of the finance service.

THE TREASURY MANAGEMENT PRACTICES 2012/13 ONWARDS

Walsall Council defines its treasury management activities as:
"The management of the organisation's 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."

Walsall Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

Walsall Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principle of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

TREASURY MANAGEMENT FUNCTION

The approved activities of the treasury management function are as follows:

Activities:

- Borrowing
- Investment of temporary surplus funds and other balances
- Setting and reviewing the treasury management strategy
- Cash flow management
- Management of school investments
- Management of debt and investments, including rescheduling, management of interest rate exposure and maturity profile management.

TMP 1 – TREASURY RISK MANAGEMENT

The Chief Finance Officer shall:

- Ensure that appropriate arrangements are in place for the design, implementation and monitoring of all arrangements related to the identification, management and control of treasury management risk.
- Report at least annually on the adequacy/suitability thereof, and report as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the council's objectives in this respect.
- In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives will be set out in schedules.

Liquidity

<u>Objective</u>: Adequate but not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable the council at all times to have the level of funds available which are necessary for the achievement of its service objectives.

Interest Rates Objective: Management of the council's exposure to fluctuations in interest rates with a view to containment of its net interest costs.
Exchange Rates Objective: Management of the council's exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.
Inflation Objective: Control of exposure to the effects of inflation, in so far as they can be identified as impacting on treasury management activities.
Credit and Counterparties Objective: To secure the principal sums invested. A counterparty list will be maintained and the named organisations and limits will reflect a prudent attitude towards organisations with whom funds may be deposited
Rescheduling and Refinancing of Debt Objective: All borrowing, private financing and partnership arrangements will be negotiated, structured and documented. The maturity profile of debt will be managed with a view to obtaining terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time. Relationships with counterparties in these transactions will be managed in such a manner as to secure this objective, and will avoid over reliance on any one source of funding if this might jeopardise achievement of the above.
Legal and Regulatory Objective: Compliance with statutory powers and regulatory requirements for all treasury management activities. The council will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under **TMP1.1.5** *Credit and Counterparty risk management,* the council will ensure that there is evidence of counterparties powers, authority and compliance in respect of the transactions they may affect with the organisation, particularly with regard to duty of care and fees charged. The council will seek to minimise the impact of future legislative or regulatory changes on its treasury management activities so far as it is reasonably able to do so.
Fraud, Error and Corruption, and Contingency Management Objective: Identification of circumstances which may expose the council to the risk of loss through fraud, corruption or other eventualities in its treasury management dealings. Employ suitable systems and procedures and maintain effective contingency management arrangements.
Market Risk Objective: Protection from adverse market fluctuations in the value of the principal sums invested.
Additional Level Risk / Reward Objective: - to ensure that the risk/ reward balance is appropriate and consistent with the risk appetite of the council the following aims are managed:- ▪ to have a large proportion of debt on fixed rates to provide stability. ▪ to have investments over a range of period lengths ▪ to use UK highly rated banks or strong building societies ▪ to obtain a fair return without any undue risk. A high risk credit rating is defined as Banks/Institutions with a national credit rating of $>$ 1.

Credit and Counterparty Risk Management

The Treasury Financial Administration and Systems Manager will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 Reporting Requirements and Management Information Arrangements.

Credit and counter-party risk is the risk of failure by a counterparty to meet its contractual obligations to the organisation under an investment, borrowing, capital project or partnership financing, particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources.

This organisation regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 Approved Instruments Methods And Techniques. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing arrangements.

Policy on the use of credit risk analysis techniques.

a. The council will use credit criteria in order to select creditworthy counterparties for placing investments with.

b. Credit ratings will be used as supplied from rating agencies – Fitch, Moodys and S&P.

c. Treasury management advisors will provide regular updates of changes to all ratings relevant to the council.

d. The Financial Administration and Systems Manager as responsible officer will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising maturity periods, type, group, sector, country and counterparty limits. The primary credit ratings Primary Credit Rating Scales which are used are shown below.

Minimum ratings	**Fitch**	**Moodys**	**S&P**
Short term	F1 or F2	P1 or P2	A
Long term	A	A	A

e. Credit ratings for individual counterparties can change at any time. The Treasury Financial Administration and Systems Manager is responsible for applying approved credit rating criteria for selecting approved counterparties. Treasury management staff will add or delete counterparties to/from the approved counterparty list in line with the policy on the criteria for selection of counterparties, and with the approval of the Treasury Financial Administration and Systems Manager.

f. This organisation will not rely solely on credit ratings in order to select and monitor the creditworthiness of counterparties. In addition to credit ratings it will therefore use other sources of information including: -

- The quality financial press
- Market data
- Information on government support for banks and the credit ratings of that government support
- The maximum maturity periods and amounts to be placed in different types of investment instrument are as follows: -

Organisation	Criteria	Max Amount	Max Period
Banks and Nationwide Building Society.	Minimum Ratings as defined above in paragraph d above. At Call Fixed term deposits LAMS scheme	£15m £10m £5m	3 years 7 years
Building Societies	Must be at least in the top 14 largest Building Society. Other Building Societies be in the top 20 in terms of proportion of free capital and profitability.	£10m £7m	2 years 3 years
Money Market Funds	AAA long-term rating backed up with lowest volatility rating (MR1+)	£15m	2 years
Non UK Banks	Minimum Ratings as defined above in paragraph d.	£10m	1 year

g. In defining the level and term of deposits significant regard is given to the proportion of the institution in government ownership.

Notes:

- The definition of 'high credit quality' is also used to determine what are specified investments as opposed to non specified investments. Specified investments are those that require minimum procedural formalities in terms of the placing of the investment by the treasury management team. Minimal procedural formalities means that the team is well experienced and knowledgeable in using these types of instruments and they pose minimal risk in their use.
- Non-specified investments may be undertaken on the approval of the Chief Finance Officer.
- To be on the council's counter party list the criteria must be passed for at least 2 of the credit ratings agencies.
- Full Individual Listings of Counterparties and Counterparty Limits is available on

request and reported regularly to the Treasury Management Panel.

Local Authority Mortgage Scheme (LAMS)
The Council is particpating in the cash backed mortgage scheme which requires the Council to place a matching five year deposit to the life of the indemnity, the deposit may be extended to up to seven years. This investment is an integral part of the policy initiative and is outside the criteria above. Cabinet agreed to adopt the LAMS scheme on 24th October 2012.LAMS Cabinet Report.

Authorisation of Payments
In order to support and maintain strong controls for the release of payments. A payment releasers register is maintained. It includes the names and post titles of officers authorised to sign financial documents releasing payments including cheques requiring manual signature and bank mandates. The payments releasers register is reviewed regularly and is approved by the Chief Finance Officer.

The Invoice / Payments Authorisation process is regulated by the financial and contract rules. Limits and authorised officers are maintained in the authorised signatories data base.

TMP 2 – BEST VALUE AND PERFORMANCE MEASUREMENT

The council actively works to promote value for money and best value in its treasury management activities. The treasury management function will be the subject of regular reviews to identify scope for improvement. In addition annual benchmarking is undertaken to measure performance and to ensure that relative to other councils the council is achieving a fair investment return without any undue risk.

TMP 3 – DECISION- MAKING AND ANALYSIS

Full records will be maintained of treasury management decisions, and of the processes and practices applied in reaching those decisions, to demonstrate that reasonable steps have been taken to ensure that all issues relevant to those decisions were taken into account.

TMP 4 – APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

Only approved instruments, methods and techniques will be used, within the limits defined in **TMP1** *Risk Management.*

Sources of Borrowing
There shall be no restriction in principle on sources or methods of borrowing other than those imposed by law. The sources or methods of borrowing at any time will be determined by the current approved treasury management strategy.

Other Sources of Finance
The Chief Finance Officer shall arrange operating leases and similar arrangements for items of equipment, vehicles, etc. where the acquisition or use of such items has been approved in line with the council's contract and rules.

Approved Organisations for Investments
The Chief Finance Officer shall approve and revise from time to time, a list of organisations within the statutory definitions of approved investments, which would be eligible to receive investments from the council. Apart from the Government, and, in any emergency, the council's own bank, the maximum limit for investment with any single organisation shall be £15 million

(£25 million for UK banks approved on counterparty list) and the maximum period for investment shall be 3 months, 1 year or 3 years in accordance with each individual institution's credibility. This review should be at least monthly and incorporate any changes in ratings of counter parties.

Interest Rate Exposure

The limits on temporary borrowing and the proportion of interest at variable rates are set by Council, in accordance with Section 45 of the Local Government & Housing Act 1989.

TMP 5 – ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES AND DEALING ARRANGEMENTS

Treasury management activities will be properly structured in a clear and open fashion and a rigorous discipline of segregation of duties will be enforced to ensure effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance.

The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions and audit of the treasury management function.

If and when the council intends, due to a lack of resources or other circumstance, to depart from these principles, the Chief Finance Officer will ensure that the reasons are properly reported in accordance with TMP6 Reporting Requirements and Management Information Arrangements and the implications properly considered and evaluated.

- The Chief Finance Officer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management and the arrangements for absence cover.
- The Chief Finance Officer will ensure that there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds.

The delegations to the Chief Finance Officer in respect of treasury management are set out in the Constitution. The Chief Finance Officer will fulfil all such responsibilities in accordance with the Policy Statement and TMPs and the Standard of Professional Practice on Treasury Management. This includes, but not exclusively, the following activity.

Activity	Prepared By	Delegation / Accountability
Approval of Treasury Management Policy and Strategy.	Head of Finance / Assistant Director of Finance	Cabinet - Policy Statement Council - Strategy
Review the debt portfolio and reschedule loans when considered appropriate	Treasury Financial Administration and Systems Manager	Chief Finance Officer
Updates to TM Practices	Treasury Financial Administration and Systems Manager	Chief Finance Officer
Undertake budget monitoring	Treasury Financial	Head of Finance

and initiate actions when necessary	Administration and Systems Manager/ Senior Accountancy Officer - Treasury	
Authorisation of loan interest payments	Accountancy Assistant – Treasury Management	Senior Accountancy Officer - Treasury
Approval of overnight investments	Accountancy Assistant – Treasury Management	Senior Accountancy Officer - Treasury
Preparation of borrowings documentation	Accountancy Assistant – Treasury Management	Senior Accountancy Officer - Treasury
To arrange borrowing from time to time for the council's purposes. Sources of funds will comprise temporary loans, loans from PWLB, other mortgages and bonds, money bills, bank overdraft and internal funds of the council, subject to any restrictions which may be made by statute, Council or Cabinet	Treasury Financial Administration and Systems Manager/ Senior Accountancy Officer - Treasury	Chief Finance Officer
Maintain Payment Releasers Register	Senior Accountancy Officer - Treasury	Chief Finance Officer
To arrange finance and operating leases as required in accordance with council's capital programme	Treasury Financial Administration and Systems Manager/ Senior Accountancy Officer - Treasury	Chief Finance Officer or Head of Finance
To invest council funds temporarily not required in accordance with the statutory provisions regulating approved investments as defined in Section 66 of the Local Government and Housing Act 1989, subject to any restrictions which may be made by statute, by Council or by Cabinet	Treasury Officer	Senior Accountancy Officer - Treasury
To maintain a counter party list of approved organisations eligible to receive council investments, this involves; - ongoing monitoring of ratings on investment products and institutions. - signing off by the treasury manager as evidence of a monthly review and mid month changes if	Senior Accountancy Officer - Treasury	Corporate Financial Systems and Treasury Manager Corporate Financial Systems and Treasury Manager Corporate Financial Systems and Treasury Manager

necessary. - if ratings change for an investment product or institution currently held then actions for a possible exit of that strategy are undertaken as approved by the Treasury Management Panel		Corporate Financial Systems and Treasury Manager and / or Chief Finance Officer dependent on limits set by TMP of exit strategy
Daily cash flow forecast	Accountancy Assistant **-**Treasury Management	Senior Accountancy Officer - Treasury
Update loan records	Accountancy Assistant **-**Treasury Management	Senior Accountancy Officer - Treasury
Operational Cash Flow	Accountancy Assistant -Treasury Management	Treasury Financial Administration and Systems Manager / Senior Accountancy Officer - Treasury
Audit and control review and improvements Recommendations implementations	Internal Audit / All	Senior Accountancy Officer - Treasury
Annual MRP Policy review	Senior Accountancy Officer – Treasury / Corporate Financial Systems and Treasury Manager	Treasury Financial Administration and Systems Manager / Senior Accountancy Officer - Treasury
Maintain accurate up to date information on Treasury Management System - Logotech	Accountancy Assistant	Senior Accountancy Officer - Treasury

TMP 6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS

Regular reports will be prepared for consideration by Council on:

- Annual report on treasury management activities for the preceding year;
- Treasury management strategy for the year, reviewed at least once during the year;

Regular monitoring reports on prudential and local indicators are prepared for the Treasury Management Panel.

Report	Frequency	When	To:
Review of Treasury Management Strategy Material changes	Annual Immediately	February/ March	Cabinet and Council Cabinet and Council
Treasury Management Annual Report	Annual	June / July	Audit Committee and Council
Review of Treasury	Annual	November	Audit Committee and Council

Management Policy			
Mid-year report	Annual	September	Audit Committee and Council
TM budget monitoring	Quarterly Monthly	July, Oct, Jan, April	Chief Finance Officer Treasury Management Panel Head of Finance for inclusion in overall corporate financial monitoring reports to CMT and Cabinet which are first reviewed by the Chief Finance Officer
TM performance indicators	Quarterly Monthly	July, Oct, Jan, April	Chief Finance Officer Treasury Management Panel Head of Finance
Cash flow summary	Monthly		Treasury Financial Administration and Systems Manager
Borrowing transactions	Monthly		Treasury Financial Administration and Systems Manager
Payment Releasers Register	Quarterly		Chief Finance Officer Head of Finance
Operational Investment strategy	Quarterly		Treasury Financial Administration and Systems Manager / Senior Accountancy Officer - Treasury
12 monthly Cash Flow	Quarterly		Treasury Financial Administration and Systems Manager / Senior Accountancy Officer - Treasury
Government statistical returns	Monthly		Office of the Deputy Prime Minister
Daily cash balance forecast	Daily		Senior Accountancy Officer - Treasury

TMP 7 – BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS
The Chief Finance Officer will prepare for Cabinet, and full Council will approve and, if necessary from time to time, will amend, an annual treasury management budget which will bring together all costs involved in running the treasury management function and associated income.
The council will account for its treasury management activities in accordance with appropriate accounting practices, standards and statutory and regulatory requirements.
The council will ensure that its auditors, and those charged with regulatory review, have access to all information and papers supporting the activities of the treasury management function as are necessary for the proper fulfilment of their roles, and that such information and papers demonstrate compliance with external and internal policies and approved practices.
In line with market convention loans office staff, when dealing, are required to commit the council to terms of borrowing and investment transactions by telephone. Although these transactions are not legally binding until confirmed in writing, if subsequently dishonoured, this may damage the council’s reputation. Electronic funds transfer requires the involvement of three officers, at least one of whom shall be on the approved list in **TMP 5.**
TMP 8 – CASH AND CASH FLOW MANAGEMENT
All council monies shall be aggregated for treasury management purposes and will be under

the control of the Chief Finance Officer. Cash flow projections will be prepared on a regular and timely basis and the Chief Finance Officer will ensure that these are adequate for the purposes of monitoring compliance with **TMP1** *Liquidity risk management.*

TMP 9 – MONEY LAUNDERING

Procedures will be enforced for verifying and recording the identity of counterparties and reporting suspicions and will ensure that staff involved in this area are properly trained.

TMP 10 – STAFF TRAINING AND QUALIFICATIONS

The council will appoint individuals to the treasury management function who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. All the council's senior treasury management staff will be CCAB qualified and have or are working towards a specific TM qualification An annual review of staff capacity including training needs and experience will be undertaken and reported to the Treasury Management Panel. Specific training for councillors will be undertaken.

TMP 11 – USE OF EXTERNAL SERVICE PROVIDERS

When external service providers are employed, the Chief Finance Officer will ensure it does so for reasons which have been subjected to a full evaluation of the costs and benefits. The terms of appointment and the methods by which service providers' value will be assessed will be properly agreed and documented.

The council does not currently require external investment managers, but recognises it may do so in the future for general or specific advice on a range of matters. These future services would be procured using the council's prevailing regulations relating to obtaining supplies and services. The council employs external treasury advisors to provide economic outlooks and information relevant to making robust investment and borrowing decisions.

TMP 12 – CORPORATE GOVERNANCE

This authority is committed to the pursuit and achievement of proper corporate governance throughout its business and services and to establish principles and practices by which this can be achieved. Accordingly the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

The council has adopted and has implemented the key recommendations of the CIPFA Code. The Chief Finance Officer will monitor and when necessary, report upon the effectiveness of these arrangements to Audit Committee.

A forum for the monitoring of Governance arrangements is the Treasury Management Panel. The Treasury Management Panel meets quarterly chaired by the Chief Finance Officer or (in his absence) the deputy Chief Finance Officer. It will receive reports on the monitoring of Prudential and Local Indicators and approve drafts of strategy and policy cabinet/council reports. It will also initiate work and projects to further ensure strong compliance of internal controls and effective treasury performance.

APPENDIX B

Treasury Management and Investment Strategy for 2013/14 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 2013/14 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
- Debt rescheduling and debt repayment
- Local Authority Mortgage Scheme(LAMS)

Annex 2
- Borrowing Objectives
- Investment Objectives
- Creditworthiness policy
- Annual Minimum Revenue Provision (MRP) Statement 2012/13 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)

ANNEX 5 - 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.

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

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion in corporate 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's treasury portfolio position at 30st November 2012 is comprised of:

Borrowing and investment 2012/13

	Borrowing £ m	Investments £ m	Net Borrowing £ m
31 March 2012	263.777	Cr 136.380	127.397
30 November 2012	264.420	Cr 125.500	138.920
Change in year	0.643	10.880	11.523

In addition to the above investments the council had at 30 November 2012 £23m in call accounts to fund current cash flows and possible debt repayment opportunities.

The council's treasury portfolio position at 30 November 2012 with forward projections are summarised below. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need, Operational Debt, highlighting any over or under borrowing.

	30st Nov 12	1st Apr 13	1st Apr 14	1st Apr 15
	£ m	**£ m**	**£ m**	**£ m**
PWLB	116.487	116.487	106.487	106.487
Market Loans	122.000	122.000	122.000	122.000
Bonds & Temporary loans	0.900	0.530	0.530	0.530
Total excluding OLA debt	**239.387**	**239.017**	**229.017**	**229.017**
Net Other L A Debt	17.085	16.474	15.802	15.063
Total including OLA debt	**256.472**	**255.491**	**244.819**	**244.080**
Operational Debt	292.093	308.866	310.476	307.096
Under / Over borrowing	**- 35.621**	**- 53.375**	**- 65.656**	**- 63.016**

The borrowing requirement

The council's capital expenditure plans are the key driver of treasury management activity and need to borrow**.** The output of the capital expenditure plans are reflected in prudential indicators which are designed to assist members overview and confirm capital expenditure plans. Draft capital Programme 2013/14 to 2015/16 is detailed below.

Draft Capital Programme 2013/14 to 2015/16			
	2013/14 £m	**2014/15 £m**	**2015/16 £m**
Anticipated Capital Resources			
Capital Receipts target	1.50	1.50	1.50
General Unsupported Borrowing	6.34	4.38	4.42
Specific Unsupported Borrowing	0.73	0.73	0.73
Previous years underspend*	0.42	0.00	0.00
Surplus capital receipts from 2012/13**	0.67	0.00	0.00
Total council funded resources	***9.66***	***6.61***	***6.65***
External Funding	30.33	20.79	14.88
Total Capital Resources	**39.99**	**27.40**	**21.53**
Capital Bids			
Council funded schemes	***9.66***	***6.61***	***6.65***
Externally funded	30.33	20.79	14.88
Total Draft Capital Programme	**39.99**	**27.40**	**21.53**
Funding shortfall (surplus)	**0.00**	**0.00**	**0.00**

PrI 4 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 of capital resources. It is essentially a measure of the council's underlying borrowing need.

Any capital expenditure which has not immediately been paid for, will increase the CFR. 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.

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 £10.4m of these schemes. Also increasing the CFR is the Local Authority Mortgage Scheme (LAMS) which also does not require the setting aside of funds to repay borrowing. The following table shows the estimated movement in the CFR over the next 3 years.

	2013/14 £m	**2014/15 £m**	**2015/16 £m**	**Total**
Net financing need for the year Draft Capital Programme	7.440	5.110	5.150	17.700
Provision for Strategic major projects and LAMS	10.000	10.000	5.000	25.000
Less MRP and other financing movements	Cr 13.285	Cr 13.500	Cr 13.530	Cr 40.315
Movement in CFR	4.155	1.610	Cr 3.380	2.385

It is prudent to reflect the possible borrowing required for large strategic projects. Such strategic projects would require business cases including repayment plans. 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 adjustment approved relating to other local authority debt backdated enables the council's MRP profile to be flexed such the revenue costs of such major projects may be managed and contained within capital financing

Thus it is currently projected that there will be a small increase in borrowing need over the next 3 years of £2.4m.

Debt rescheduling and debt repayment

This increase in borrowing can be managed by the use of internal balances. However a £10m PWLB loan does mature in 2013/14. The borrowing requirement will continue to be monitored as will any debt rescheduling opportunities.

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 reported to the Treasury Management Panel at the earliest meeting following its action.

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

Borrowing rates

The Sector forecast for the PWLB new borrowing rate is as follows: -

	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Sep-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50 %	0.50%	0.50%	1.00%
5yr PWLB rate	1.50%	1.50%	1.60%	1.70%	1.80%	2.00%	2.30%
10yr PWLB rate	2.50%	2.50%	2.60%	2.70%	1.80%	3.00%	3.30%
25yr PWLB rate	3.70%	3.70%	3.80%	3.80%	3.90%	4.10%	4.30%
50yr PWLB rate	3.90%	3.90%	3.80%	4.00%	4.10%	4.30%	4.50%

A more detailed Sector forecast and economic is included in **Annex 4.**

Local Authority Mortgage Scheme (LAMS)

The council is participating in LAMS in which the mortgage lenders require a five year deposit from the local authority to match the five year life of the indemnity, the period of deposit may be extended to seven years if required. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The capital financing requirement (CFR) increases by the amount of the total indemnity (£5m). The deposit is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

ANNEX 2: TREASURY MANAGEMENT AND INVESTMENT STRATEGIES - 2013/14 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 1** 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 and – This indicator has been updated to reflected the funding regime for local government
- **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 4.52% - **No Change**
- **L6.** Average interest rate for total debt (including other local authority debt) will be equal to or less than 4.63%. **– No Change**

- **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 **– 0.5% - Changed from 0.75% to reflect market conditions**
    (b) Short term investments – **0.9% - Changed from 1.5% to reflect market conditions**
    (c) Long term investments – **2.0%** - **Changed from 2.5% to reflect market conditions.**
- L10 Average rate on short term investments will be equal to or greater than **0.8%** - **Change from 1.1% due to market conditions**.
- L11. Average rate on all investments will be equal to or greater than **1%** - **Change from 1.3% % due to expected market conditions**
- L12 % daily bank balances within a target range of 98% **- No Change**

<u>Creditworthiness policy</u>

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 Council on 7 November 2011.

The Monitoring of Investment Counterparties

The credit rating of counterparties will be monitored regularly. The council receives credit rating information from Sector as and when rating changes 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 2013/14 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 2013/14 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 of added significantly to the lifespan of the asset 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 beginning to make 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 is equivalent to the principal payment contained with the lease terms.

ANNEX 3 – CAPITAL PRUDENTIAL INDICATORS FOR 2013/14, 2014/15 & 2015/16

The council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members 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 council from 2013/14 to 2015/16. More details on prudential indicators 11 and 12 are shown in table 2.

Table 1: National Prudential Indicators 2013/14 to 2015/16				
No.	**Indicator**	**2013/14**	**2014/15**	**2015/16**
PCI 1	**Total capital expenditure**	£ m 39.990	£ m 27.40	£ m 21.53
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**	10.7%	10.7%	10.7%
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.**	£8.82	£6.02	£6.07
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 319.279	£ m 320.889	£ m 317.509
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	2013/14	2014/15	2015/16
PCI 5	**Authorised limit for external debt.**	£ m 351.207	£ m 352.977	£ m 349.620
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.				
No.	**Indicator**	**2013/14**	**2014/15**	**2015/16**
PCI 6	**Operational boundary for external debt.**	£ m 308.866	£ m 310.476	£ m 307.096
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	2013/14	2014/15	2015/16
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 local PrIs proposed for 2013/14 to 2015/16.

Table 3: Local Prudential Indicators 2012/13 to 2015/16				
No.	**Indicator**	**2013/14**	**2014/15**	**2015/16**
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**	**11.50%**	**11.0%**	**10.75%**
	b. Net borrowing costs as % of council tax requirement and NNDR contribution	**6.5%%**	**6.25%**	**6.00%**
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**	**4.52%**	**4.52%**	**4.52%**
L.6	**Average interest rate of debt including OLA**	**4.63%**	**4.63%**	**4.63%**
The measure should be as low as possible. Other Local Authority debt (OLA) is managed on our behalf by Dudley council.				

No.	Indicator	2013/14	2014/15	2015/16
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	**0.50%**	**0.50%**	**0.75%**
	(b) Short Term investments	**0.90%**	**1.00%**	**1.20%**
	(c) Long Term investments	**2.00%**	**2.50%**	**3.00%**
L.10	**Average interest rate on all ST investments. (ST and At call)**	**0.8%**	**1.1%**	**1.4%**
A recognised PI for measuring the performance of return on investments.				
L.11	**Average rate on all investments**	**1.0%**	**1.4%**	**1.8%**
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 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 is unlikely to prove anything more than a washing out of the dip in the previous quarter before a return to weak, or even negative, growth in quarter 4.

The **Eurozone sovereign debt crisis** has abated somewhat following the European Central Bank'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. 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 at the start of 2013.

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 upside 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).

POLICY ON USE OF EXTERNAL SERVICE PROVIDERS

The council uses 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.

EXPLANATION OF TECHNICAL 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.
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
Investments	The employment of money with the aim of receiving a return.
LIBID	London inter banking bid rate
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
Non specified investments	Investments with a maturity exceeding a year
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.
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 authorities' capital investment plans are affordable, prudent and sustainable.
Short Term Borrowing	Borrowing of money for a term of up to 364 days.
Stock	Subscribed capital of trading company, or public debt of nation, municipal corporation etc regarded as transferable property
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.