East Devon District Council Treasury Management Strategy 2015/16

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

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1. **Introduction**

1.1 Background

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

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

The Council operates its treasury management function with reference to the Chartered Institute of Public Finance & Accounting Guidance laid out in the Code of Practice for Treasury Management in Public Services (CIPFA Code) and the Department for Communities & Local Government (CLG) Guidance on Local Government Investments.

CIPFA defines treasury management as:

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

The Council adopts the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. All treasury management matters are undertaken in accordance with the code, which recommends best practice in treasury management, including setting a strategy and reporting requirements.

1.2 Reporting Requirements

Under the CIPFA Code and CLG Guidance the Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and Treasury Indicators and Treasury Strategy

This, the first, and most important report covers:

- the capital plans (including prudential indicators);

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

A mid year treasury management report

This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report

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

In addition to the above reports, Cabinet will be provided with an overview of treasury return against budget and prediction of likely outturn and year end variance as part of the financial monitoring reports presented to Cabinet throughout the year.

1.3 Treasury Management Strategy for 2015/16

The strategy for 2015/16 covers two main areas:

Capital issues

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

Treasury management issues

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

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

1.4 Training and Review

CIPFA's revised code requires the Strategic Lead Finance (Section 151 Officer) to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

The training needs of treasury management officers are periodically reviewed. There is a post with specific responsibility for treasury management within the accountancy team and the Council is committed to ensuring the holder has the relevant qualifications and has access to the training and support required to undertake this role.

In addition, the Council's treasury management team has recently joined the South West Treasury Management Benchmarking Group hosted by Capita Asset Services. This group currently has members from 14 authorities and provides a forum for interpreting Treasury Management data across the area and sharing best practice. The group also allows the opportunity to consider any potential forthcoming treasury management risks, the early identification of which can aid proactive investment management.

The Council maintains an internal audit function through the South West Audit Partnership (SWAP). SWAP undertakes a periodic internal audit review of the treasury management function. In the latest audit by SWAP, which covered the 2013/14 financial year, the treasury management function was given a Substantial Opinion, which is the highest opinion available.

Further review is also provided by the external audit team, currently Grant Thornton, who consider the reporting of treasury management data within the financial statements as part of their external audit opinion work.

1.5 Treasury Management Consultants

The Council uses Capita Asset Services, Treasury Solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon its 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. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed, documented, and subjected to regular review.

2 The Capital and Prudential Indicators 2015/16 – 2017/18

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirmation of the capital expenditure plans.

These indicators help show the effect of the financing and borrowing strategy that the Council plans to adopt over the next three financial years.

The Prudential Code and the indicators set, support the system of capital investment in the authority. They are set with regard to:

- Service objectives – strategic planning for the authority
- Stewardship of assets – asset management planning
- Value for money – option appraisal
- Prudence and sustainability – external borrowing implications
- Affordability – implications for council tax and housing rents
- Practicality – achievability of the forward plan

The indicators also act as an early warning system, to flag up if the Council decides to set capital programmes without the necessary finances to fund them.

The indicators shown in this report exclude any capital and borrowing implications of any decision that full Council may make on the office relocation. Once a decision is reached, revised indicators will be submitted for approval.

2.1 Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Table 1 shows both actual capital expenditure incurred in 2013/14 and estimates for the years 2014/15 to 2017/18.

Table 1. Total Capital Expenditure to be incurred (Actual and Estimated)

	Actual	Per 15/16 Estimates			
	2013/14	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	£000	**£000**	**£000**	**£000**	**£000**
General Fund	5,759	18,046	4,189	4,017	6,216
HRA	1,208	1,565	625	625	625
Sub Total	**6,967**	**19,611**	**4,814**	**4,642**	**6,841**
Major Repairs	5,635	5,150	4,996	5,150	5,150
Total	**12,602**	**24,761**	**9,810**	**9,792**	**11,991**

These figures show the Council's capital programme net of any grants or contributions received from third parties. The total capital expenditure also includes that related to major repairs, which for accounting purposes is shown within the HRA.

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

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

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

In summary the CFR represents the Council's underlying need to borrow for capital purposes less any principal already repaid.

The Council's Capital Programme is funded from various sources:

- Use of capital receipts (sale proceeds from assets)
- Contributions from revenue budgets
- Capital grants e.g. Environment Agency Grants, Disabled Facility Grant
- Contributions from other parties e.g. Devon County Council

Any planned expenditure in excess of the above funding streams is known as an unfunded balance which can be met from reserves or borrowing. The Capital Reserve at Year End 2013/14 stood at £2.510m.

Table 2 shows both the actual CFR for 2013/14 and the estimates for 2014/15 to 2017/18. The Council is asked to approve these projections.

Table 2. Capital Financing Requirement (CFR)					
	Actual	**Per 15/16 Estimates**			
	2013/14	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	£000	**£000**	**£000**	**£000**	**£000**
General Fund	746	4,295	5,429	5,684	8,816
Housing Revenue Account	85,007	84,427	83,398	81,908	80,598
Totals	**85,753**	**88,722**	**88,827**	**87,592**	**89,414**
Movement in CFR	**245**	**2,969**	**105**	**(1,235)**	**1,822**
Movement in CFR Represented by					
Net Financing need for the year	305	3,605	1,259	1,444	3,265
Less MRP* and other financing movements	(60)	(636)	(1,154)	(2,679)	(1,443)
	245	**2,969**	**105**	**(1,235)**	**1,822**

* MRP – Minimum Revenue Provision

2.3 Current Portfolio Position of Gross Debt

Table 3 shows the Council's gross debt for 2013/14 and the estimated debt balance as each year end from 2014/15 to 2017/18.

Table 3. Total Borrowing Outstanding					
	Actual	**Per 15/16 Estimates**			
	2013/14	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	£000	**£000**	**£000**	**£000**	**£000**
Borrowing					
General Fund	1,346	6,645	7,789	8,044	11,186
Housing Revenue Account	85,007	84,427	83,398	81,908	80,598
Total Borrowing	**86,353**	**91,072**	**91,187**	**89,952**	**91,784**

2.4 Gross Debt v Capital Financing Requirement (CFR)

A comparison of the Councils Gross Debt to CFR is required by the Prudential Code, with explanations of any variances, to ensure that over the medium term the council only borrows to fund its capital programme. This is shown in Table 4.

Table 4. Gross Debt v Capital Financing Requirement					
	Actual	**Per 15/16 Estimates**			
	2013/14	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	£000	**£000**	**£000**	**£000**	**£000**
Gross Debt	86,353	91,072	91,187	89,952	91,784
Total CFR	85,753	88,722	88,827	87,592	89,414
Sub total	**600**	**2,350**	**2,360**	**2,360**	**2,370**
Cash Flow Borrowing	600	2,350	2,360	2,360	2,370
Variance	**0**	**0**	**0**	**0**	**0**

The 2013/14 Statement of Accounts showed £0.6m short term borrowing for cash flow purposes and £85.7m in loans from Public Works Loan Board (PWLB). From 2015/16 onwards estimates are used, based on known and expected borrowing both for capital and cash flow purposes.

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Strategic Lead Finance reports that the Council complied with this prudential indicator in 2013/14 and does not envisage difficulties for future compliance. This view takes into account current commitments, existing plans, and the proposals in this budget report.

2.5 Minimum Revenue Provision (MRP) Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement*:*

For all unsupported borrowing (including finance leases) the MRP policy will be:

- Asset life (Annuity) Method; – MRP is the principal element for the year of the annuity required to repay over the asset life the amount of capital expenditure financed by borrowing (option 3).

This option provides for a reduction in the borrowing need over approximately the asset's life. The use of this option by EDDC is consistent with the prior year, and is recognised by CIPFA as being the most popular option in practice.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made. In practice a loan repayment scheme has been defined based on the business plan, with a balance being struck between repaying as soon as possible and allowing the HRA to generate sufficient surpluses as a cushion against uncertainties and to carry out improvements to stock.

Repayments included for finance leases are applied as MRP.

2.6 Affordability Prudential Indicators

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

The Council is asked to approve the following indicators:

2.6.1 Ratio of Financing Costs to Net Revenue Stream

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

Table 5 shows how this indicator is calculated. A positive figure indicates external debt.

Table 5. Basis of Calculation for Ratio of Financing Costs to Net Revenue Stream				
General Fund (GF):				
Financing costs Minimum Revenue Provision (see 9.0) Plus Interest charged on loans and Finance Leases Less Interest earned on investments	**÷**	**Budget requirement** Revenue Support Grant + Council Tax	**=**	**The ratio of financing costs to net revenue stream (General Fund)** as a %
Housing Revenue Account (HRA):				
Financing costs Voluntary Revenue Provision (see 9.0) Plus Interest charged on loans and Finance Leases Less Interest earned on investments	**÷**	**Budget requirement** Council house tenants income +/- Contribution to or from HRA reserves	**=**	**The ratio of financing costs to net revenue stream (HRA)** as a %

Table 6 shows both the actual ratio of financing costs to net revenue stream for 2013/14 and the estimates for 2014/15 to 2017/18.

Table 6. Ratio of Financing Costs to Net Revenue Stream					
	Actual	**Per 15/16 Estimates**			
	2013/14	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	%	**%**	**%**	**%**	**%**
General Fund	(1.82)	(0.57)	(0.10)	(2.39)	(3.07)
HRA	16.39	18.71	20.06	23.66	22.02

The General Fund ratio reflects the estimation that a higher level of investment income is received compared to that paid out in borrowing. From 2016/17 the financing costs start to decrease as capital receipts start to increase, therefore reducing the need for loan finance. In addition from 2016/17 onwards the impact of potential increases in the Bank of England base rate has been factored into investment returns, which reduces the ratio further.

The HRA ratio changes from 2014/15 onwards are as a result of the principal associated with the HRA self financing loans becoming due.

2.6.2 Incremental Impact of Capital Investment Decisions on Council Tax and Average Weekly Housing Rents

Table 7 shows the incremental impact of capital investment decisions proposed in the budget report. Only the financing costs associated with the General Fund capital loans are included within the calculation of impact on annual council tax, and only the financing costs associated with HRA capital loans are included within the calculation of the impact on average weekly housing rent.

The indicator takes into account the Council Tax base of 55,289 (2014: 54,047) and housing stock of 4,248 (2014: 4,263) for 2015/16.

Table 7. Incremental Impact of New Capital Investment Decisions on Council Tax and Weekly Housing Rents					
	Actual	**Per 15/16 Estimates**			
	2013/14	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	£	**£**	**£**	**£**	**£**
Band D Annual Council Tax	1.39	1.61	4.57	4.77	5.04
Average Weekly Housing Rent	11.55	14.18	16.24	18.35	17.51

3 Borrowing

The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This includes both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury and prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 General Fund

The Council's General Fund (GF) currently has one annuity loan. This will have a remaining capital balance of £0.385m as at the end of 2014/15 from the Public Works Loan Board (PWLB) for recycling & refuse. The annual debt repayment for this loan is £0.072m (including interest of £0.016m for 2014/15). This loan is at a fixed rate of interest and includes an annual repayment of both principal and interest, which due to its nature vary each year depending on the loan balance.

The GF also has two maturity PWLB loans with remaining capital balances totalling £1.06m as at the end of 2014/15. The Council has then loaned the same amount onto Beer Community Land Trust Limited at the same rates as those charged to EDDC by PWLB. For 2014/15 the annual interest payments on these loans is £0.02m for a full year's charge. In effect this loan has a nil cost in cash terms to EDDC. These loans are to facilitate the building of affordable housing in Beer for the local community.

The capital plan shows further planned borrowing of £1.45m in 2014/15, to finance a loan issued to Leisure East Devon (LED) in order to fund the leisure centre enhancement programme. During December 2014 Council approved a further £0.4m to be loaned to LED, bringing the total to £1.85m. This loan will be issued to LED with the same interest rate charge and associated fees which EDDC is required to pay to PWLB. In effect this loan will also be cost neutral for the Council in cash terms. As yet this loan has not been drawn down or issued.

Full Council has also approved up to a further £1.0m in borrowing from the PWLB to extend a loan to Exeter Science Park Company Ltd to facilitate the building of the Science Park Centre. As yet this loan has not been drawn down or issued.

If all of these loans were taken out before the end of 2014/15 the General Fund will have loans totalling nearly £4.3m at the year end.

The 2014/15 Treasury Management Strategy referred to a planned capital loan of £0.77m to support the development and redevelopment of industrial sites in Seaton. As yet this loan has not been requested and it is unlikely to be required prior to the current year end. This loan has not been included in the capital financing calculations.

The 2015/16 Capital Programme includes provision for a potential new 3 year PWLB loan of £1.259m. This is the first in a series of potential loans required over the next 3 years to fund the Exmouth Regeneration Programme. Capital receipts from the programme itself are not expected to be received until 2018/19 and potential loan funding has been profiled on this basis.

The 2015/16 capital estimates indicate that between 2015 and 2017 a total of £7.834m will be required to fund Exmouth regeneration in advance of capital receipts. In order to achieve the best value for money for the Council, officers are reviewing whether PWLB finance, disinvestment, or a combination of the two is likely to be the best option to fund this programme. The funding strategy is dependent on the amount and timing of expenditure, given the market conditions at the time, and is likely to be via a combination of external fund disinvestment, use of capital receipts, and/or a loan from PWLB. The 2015/16 Capital Financing Plan currently estimates that £1.866m will be internally funded over the 3 year period. Further financing information will be provided to Council as this project evolves.

3.2 Housing Revenue Account (HRA)

As at 31 December 2014 the HRA had 25 PWLB Loans totalling just over £85m. Of these, 24 are maturity loans varying in duration from 3 - 26 years taken out under the governments self financing regime. The 25th loan is an annuity loan (repaying principal each year) which was taken out in March 2011 for 17 new build properties. It is expected that the 2014/15 year-end position on these loans will be £84.5m.

The remaining capital balance on the 24 maturity PWLB loans will total £83.802m at the end of this financial year. The resulting interest payments associated with these loans is £2.5m during this financial year. The principal amount borrowed is repayable at the end of the loan, with the first repayment due to be made in March 2015.

These loan repayments have been profiled in line with the business plan generating resources to be able to repay the principal, with a balance being struck between repaying as soon as possible and allowing the HRA to generate sufficient surpluses as a cushion against uncertainties and enabling it to carry out improvements to stock.

The HRA annuity PWLB loan will have an outstanding capital balance of £0.625m at the end of this financial year. During 2014/15 £0.039m was paid out against this loan and this included interest of £0.060m. This loan is at a fixed rate of interest and includes an annual repayment of both principal and interest, which due to its nature vary each year depending on the loan balance.

The effect of these Capital loans is an increase of £2.96 in the proportion of the Council's Band D tax level used for capital financing costs. This increases from £1.61 in 2014/15 to £4.57 in 2015/16, (Table 7).

The financing effect of these loans on average weekly rents was £11.55 in 2013/14, (£11.35 in 2012/13), (Table 7).

3.3 Cash Flow or Temporary Borrowing

In addition to borrowing for capital purposes, the council also borrows in the short-term to meet day to day shortages in its cash flow.

This borrowing is normally overnight via the call account overdraft. In some instances, particularly around the year end, the overdraft may not provide a sufficient short-term buffer, and in these instances the council will borrow via the market at fixed rates for a fixed term of less than 3 months.

At the end of 2013/14 there was a requirement for £0.305m short-term borrowing over the year end. Currently there is no indication that such borrowing will be required at the end of 2014/15.

3.4 Treasury Indicators: Limits to Borrowing activity

As part of the CIPFA code for Treasury Management it is recommended that the Council is informed of the anticipated borrowing limits required for the forthcoming financial year.

In addition to loans mentioned earlier, the Council will still need to make use of short term borrowing to meet day to day cash flow shortfalls.

The limits on the level of borrowings are stated below at 3.5 and 3.6.

3.5 The Operational Boundary for External Debt

This is the limit which external debt is not normally expected to exceed. This is the prudent level of external debt that the Council estimates will be required during any one year in terms of its capital financing and cash flow requirements. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt. The Council is asked to approve these limits and to delegate authority to the Section 151 Officer to exceed these agreed limits and report back to cabinet, immediately after the event.

Table 8 shows both the actual operational boundary for external debt for 2013/14 and the estimates for 2014/15 to 2017/18. The operational boundary for any particular year has to be the higher of the opening and closing positions during that year.

Table 8. Operational Boundary for External Debt (Estimated)					
	Actual	**Per 15/16 Estimates as at 07/01/15**			
	2013/14	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	£000	**£000**	**£000**	**£000**	**£000**
Borrowing - General Fund	1,346	6,645	7,789	8,044	11,186
Other LTL's* - General Fund	568	568	407	361	379
General Fund Total	**1,914**	**7,213**	**8,196**	**8,405**	**11,565**
Borrowing - HRA	85,007	85,007	84,427	83,398	81,908
Other LTL's* - HRA	0	0	0	0	0
HRA Total	**85,007**	**85,007**	**84,427**	**83,398**	**81,908**
Overall Total	**86,921**	**92,220**	**92,623**	**91,803**	**93,473**

*****LTL’s – Long Term Liabilities, e.g. Finance lease costs.

3.6 The Authorised Limit for External Debt

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

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

The authorised limit is based on the Council’s estimate of the most likely and prudent requirement for external debt (borrowing) during the year (the operational boundary) plus additional headroom for unanticipated cash movements, including those due to slippage.

For the General Fund the headroom is set at £3.0m.

For the HRA a debt cap of £87.844m set by the Government as the authorised limit has been used.

External debt is the sum of both debt to fund capital items, and short term borrowings to meet day to day cash flow variations.

In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt and to delegate authority to the Section 151 Officer (Strategic Lead Finance), to operate within the total limit for any individual year.

It is the duty of the Section 151 Officer to ensure that the authorised limits are consistent with the Council's current and future capital requirements. These limits should take account of risk management strategies, with regard to capital schemes and all future cash flow predictions, including the headroom referred to above for unexpected cash movements.

Table 9 shows the actual external debt for 2013/14 and the Authorised Limit for external debt for 2014/15 to 2017/18, based on estimates for capital expenditure and financing. The Council is asked to approve the following authorised limits:

Table 9. Authorised Limit for External debt (Estimated)					
	Actual	**Per 15/16 Estimates as at 07/01/15**			
	2013/14	**2014/15**	**2015/16**	**2016/17**	**2017/18**
	£000	**£000**	**£000**	**£000**	**£000**
Borrowing - General Fund	1,346	9,645	10,789	11,044	14,186
Other LTL's* - General Fund	568	568	407	361	379
General Fund Total	**1,914**	**10,213**	**11,196**	**11,405**	**14,565**
Borrowing - HRA	85,007	87,844	87,844	87,844	87,844
Other LTL's* - HRA	0	0	0	0	0
HRA Total	**85,007**	**87,844**	**87,844**	**87,844**	**87,844**
Overall Total	**86,921**	**98,057**	**99,040**	**99,249**	**102,409**

*****LTL's – Long Term Liabilities, e.g. Finance lease costs.

The Council's actual external debt at 31 March 2014 was £86.92m (General Fund £1.91m and HRA £85.01m).

3.7 Prospects for Interest Rates

The Council has appointed Capita Asset Services as its treasury advisor and part of its service is to assist the Council to formulate a view on interest rates.

Appendix 1 provides their interest rate forecast and central view.

3.8 Treasury Management Limits on Activity

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

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

The Council is asked to approve the following treasury indicators and limits:

3.9 Interest Rate Exposure

Based on the projected investment and borrowing requirements of the Council over the next three years the upper limit on fixed and variable interest rate exposure is outlined in Table 10.

Table 10. Interest Rate Exposure

	General Fund		**HRA**	
	Fixed	**Variable**	**Fixed**	**Variable**
2014/15 Limits				
Borrowing	100 %	20%	100%	20%
Investments	60%	100%	60%	100%
2015/16 Limits				
Borrowing	100%	20%	100%	20%
Investments	60%	100%	60%	100%
2016/17 Limits				
Borrowing	100%	20%	100%	20%
Investments	60%	100%	60%	100%

With the exception of the bank overdraft, all borrowing the Council undertakes is at a fixed rate of interest.

Investments have a 100% variable upper limit, as currently the majority of returns are variable including the external investment funds, 'savings' account, and money market fund investments. The fixed element of investments has been increased this year to 60% from 40%. The reason for this increase is not due to a change in the treasury management activities as such, but reflects non-treasury management, policy based investment decisions. All investments of this nature are on a fixed term basis, whereby any interest chargeable on a project is then recharged on to the project itself, the idea being that in cash terms there is a nil impact on the Council. The loan to LED as referred to elsewhere within this report is one such example of a policy based investment decision.

The upper limit on variable borrowing at 20% ensures a level of certainty for Council borrowing, and thus cash outflows. The upper limit on fixed investments helps to protect the council from interest rate risk. For example it is not in the best interests of the Council to have too much cash tied up in a fixed return investment in the event of an interest rate rise, which would mean better returns may be had elsewhere. Variable rate investments often track the base rate, thus removing the risk associated with interest rate changes.

3.10 Maturity Structure of Borrowing

This is the amount of projected long term capital borrowing that is due for repayment in each period expressed as a percentage of total borrowing. A limit is set to reduce the Council's exposure to large sums falling due in any one period.

At any point the actual percentages of debt projected to mature in each year will add up to 100%, but the proposed indicator is for a range of approved percentages. This gives discretion within an approved range to the treasury team. It does mean that each 'set' of figures will sum to more than 100%.

The council is asked to approve the following limits as outlined in Table 11:

Table 11. Limits on Maturity Structure of Fixed Rate Borrowing as % of Total Borrowing

		General Fund		HRA	
		Upper Limit	**Lower Limit**	**Upper Limit**	**Lower Limit**
Current Year	2014/15	20%	0%	20%	0%
Next yr	2015/16	20%	0%	20%	0%
Yr 3-5	2016/17 - 2018/19	75%	0%	20%	0%
Y6 -10	2019/20 - 2023/24	20%	0%	20%	0%
Y11+	2024/25 – 2053/54	25%	0%	80%	0%

The upper limit in the General Fund for year's three to five is due to the impact of the repayment of the potential Exmouth Regeneration loan. Within the HRA the majority of the loans are over the longer term, resulting in the upper limit being higher from 2024 onwards.

Based on capital borrowing plans included in the budget the current projected maturity structure of borrowing is shown in Table 12:

Table 12. Estimated Maturity Structure of Fixed Rate Borrowing as % of Total Borrowing

		General Fund		HRA	
		Projected Borrowing Amount Maturing £000	**Total**	**Projected Borrowing Amount Maturing £000**	**Total**
Current Year	2014/15	56	**0.54%**	580	**0.68%**
Next yr	2015/16	125	**1.21%**	1,029	**1.21%**
Yr 3-5	2016/17 - 2018/19	7,301	**70.75%**	4,388	**5.16%**
Y6 -10	2019/20 - 2023/24	468	**4.54%**	12,973	**15.26%**
Y11-20	2024/25 - 2033/34	2,107	**20.42%**	40,988	**48.22%**
Y21-30	2034/35 - 2043/44	192	**1.86%**	24,823	**29.2%**
Yr31-40	2044/45 - 2050/51	70	**0.68%**	226	**0.27%**
		10,319	**100.00%**	**85,007**	**100.00%**

The General Fund maturity structure of borrowing shows a significant percentage of borrowing is to be repaid in year’s three to five, and year’s eleven to twenty. This is consistent with the limits on the maturity structure of borrowing, and is as a result of the repayment of debts associated with the Exmouth Regeneration Programme, and the Science Park Company Limited respectively.

In addition to the above, the Council has an overdraft limit of £0.35m and can borrow for periods less than 3 months at fixed rates, in order to meet daily cash flow requirements.

3.11 Upper Limit for Total Principal Sums Invested over 364 days

Only the Council’s external funds can be invested for over 364 days and these total £30.92m. In practice the council can access this money with 3 days notice.

3.12 Policy on Borrowing in Advance of Need

The Council should not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed.

Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Borrowing in advance will be made within the constraints that it will:

- be limited to no more than the expected increase in borrowing need;
- occur not more than 3 months in advance of need; and,
- be agreed with the Section 151 Officer and Portfolio Holder for Finance in advance.

The risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.13 Debt Rescheduling

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

The reasons for any rescheduling to take place will include:

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

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

There are currently no plans to restructure the Council’s debt portfolio, however this will be kept under review as market conditions change.

4 Annual Investment Strategy

4.1 Investment Policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The Council's Overriding Investment policy objective is to prudently manage the Council's funds, ensuring that risks are minimised whilst maximising returns. The Council's investment priorities in order of importance are:

- Security of the invested capital
- Liquidity of the invested capital
- Yield (return on investment)

In accordance with the above objective and in order to minimise risk to the principal sums invested, the Council sets parameters which are assessed when considering the credit risk of potential counterparties to include on the lending list. These parameters include the minimum acceptable credit quality of counterparties, i.e.their creditworthiness, and their net asset value as applicable.

The creditworthiness methodology used to create the counterparty list takes account of the ratings, watches and outlooks published by three ratings agencies, as advised by CIPFA. The agency data used is that published by Fitch, Moody's, and Standard & Poors.

The Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and therefore other sources of information are used as relevant including:

- Financial press articles (macro-economic, banking, and individual institutions)
- Share price
- Other information pertaining to the banking sector
- Support - this is the perceived support an institution will get from the government in the institutions country of origin based on news articles and market sentiment
- Annual accounts of Building Societies

4.2 Creditworthiness Policy

Counterparty ratings are monitored on a real time basis via notifications received from Capita Asset Services as the agencies publish modifications. In addition a full review of the counterparty list is carried out monthly.

The security of the Council's financial assets is paramount, and whilst the strategy needs to be clear in this area it also needs be sufficiently comprehensive and itterative in order to provide operational flexibility within, what at times, is a volatile macroeconomic environment. As the financial backdrop changes it is essential that the strategy is set to enable an efficient response to those changes.

The 2014/15 strategy allows for investments of up to £2.0m to be deposited with UK incorporated banks, or those banks entitled to receive UK deposits. However the reality during the current financial year is that the banks have not been willing to accept investments for the amounts and periods the Council has been able to offer. Market sentiment indicates that this will continue into the forseeable future with the added risk that call account returns are likely to reduce. This demonstrates that whilst it is important to include a range of parameters within a comprehensive strategy it is also important to recognise the practicality of such parameters.

Given the opportunities for investment, the council manages the majority of its internal investments via the CCLA and a range of building societies in line with the creditworthiness criteria referred to below.

In order to address the need for flexibilty, and to ensure the spread of risk, access to an investment portal has been arranged which allows officers to review and potentially transact with a small range of money market funds directly. All money market funds considered suitable with reference the creditworthiness criteria will be approved for use by the Section 151 Officer before an account is opened. The controls in place will be as stringent as those for transacting with the CCLA, which is currently the only money market fund the Council uses to manage short term cash flow.

A very difficult investment environment remains. Whilst counterparty risk appears to have eased, it remains at elevated levels and economic forecasts are abound with uncertainty. However, the UK also has a very accommodating monetary policy - reflected in a 0.5% bank rate, several tranches of quantitative easing and the Funding for Lending initiative. As a consequence, investment rates of returns for authorities continue to be depressed.

The basis of the current strategy has been in place for several years, and it is therefore considered appropriate to consider whether it remains fit for purpose. The Treasury Management Performance 2014/15 – 1 April 2014 to 30 September 2014 report noted that the EDDC treasury management team is undertaking a review of the Treasury Management Strategies of a sample of other comparable district councils, with the aim of benchmarking the EDDC strategy in comparison. This work is still ongoing, but if on conclusion of that work an amendment to the strategy is required, this will be presented to Council as a separate report.

The Council's creditworthiness criteria are laid out in the Table13 below, these are consistent with the 2014/15 strategy.

Table 13. Creditworthiness Criteria		
Organisation	**Criteria**	**Max Amount**
External (Long Term) Investment Fund		
Collective investment schemes (e.g. bond funds)	AAA long-term rating backed up with lowest volatility rating (V1/S1)	60% of External Fund total
Cash Flow/Internal Investments		
Deposit Building Societies	With over £5 Billion in total assets	£3m
Deposit Building Societies	With over £1 Billion in total assets	£2m
Deposit with UK incorporated Banks	Minimum F1, A1 or P1 short term backed up by A long term credit rating	£2m
Deposit with Banks Incorporated outside the UK but entitled to accept deposits in UK	Minimum F1+, A1+ or P1+ short term backed up by AA- long term credit rating	£2m
Money Market Funds	AAAmmf long-term rating	£3m
UK Local, Police & Fire Authorities		£3m
UK Government Treasury Bills/Gilts		No limit

The Council's current counterparty list is included at Appendix 3.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the short term and long term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant.

This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes. EDDC refers only to the short and long term ratings when assessing counterparies, as such its review of counterparty creditworthiness will not be affected by this regulatory change which has been referred to here for information only.

The Council will not invest in subsidiaries that do not have a credit rating in their own right and a separate FSA licence from the parent company.

In the event of a downgrade resulting in a counterparty or investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

Any changes in counterparty ratings or other criteria that put the counterparty below the minimum criteria whilst they hold a deposit will be brought to the attention of the Strategic Lead Finance and the Portfolio Holder for Finance immediately, with an appropriate response decided on a case-by-case basis.

4.3 Specified and Non-Specified Investments

Specified Investments are required to be in Sterling and have a maximum maturity of 1 year and be of ‘high credit quality’.

The definition of ‘high credit quality’ is set out below:

- Investments in Banks Incorporated in the UK with a credit rating of at least A/F1, A1 or P1 with a limit of £2m on the amount invested.

- Investments in Banks Incorporated outside of the UK but entitled to accept deposits in the UK, per the Bank of England Prudential Regulation Authority list of banks, with a credit rating of at least AA-/F1+/A1+/P1 with a limit of £2m on the amount invested.

- Investments in collective investment schemes, including money market funds, structured as Open Ended Investment Companies (OEIC’s) with a long term rating of AAAmmf for Constant Net Asset Value (CNAV) funds and AAA V1/S1 for Variable Net Asset Values (VNAV).

- Internal Investments less than 6 months, up to agreed limits, in UK Building Society’s with an asset basis of over £1 billion.

All investments over 1 year in duration and/or not meeting the definition of high credit quality listed above are classified as non-specified investments.

4.4 Current Investment and Borrowing Position

The current position on debt and investment principal as at 31 December 2014 is show in Table 14.

Table 14. Current Investment and Borrowing Position		
	£M	
Short Term Internal Investments		
Bank of Scotland call account	2.00	
Public Sector Deposit Fund (Money Market Fund – Call Account)	0.40	
Fixed Term Cash Deposits < 1 Month	0.00	
Fixed Term Cash Deposits < 2 Month	3.00	
Fixed Term Cash Deposits < 3 Month	8.50	
Fixed Term Cash Deposits < 4 Month	2.00	
	15.90	**33.96%**
External Investments		
Royal London Asset Management - Cash Plus Fund	15.46	**33.02%**
Payden & Rygel - Sterling Reserve Fund	15.46	**33.02%**
	30.92	
Total Investments	**46.82**	
Borrowing		
Short Term Cash Flow Borrowing	0.00	
PWLB Loan (General Fund) < 10 years	1.47	
PWLB Loan (HRA) < 40 years	84.43	
	85.90	

4.5 External Funds

The council currently has over £30m invested, split equally between the following pooled investment vehicles, OEIC's:

- Cash Plus Fund – Royal London Asset Management (RLAM)
- Sterling Liquidity Fund – Payden & Rygel

4.6 End of year investment report

At the end of the financial year, the Council will be provied with a detailed report on its investment activity as part of the Annual Treasury Report.

5. Other Items

5.1 Use of Reserves

The draft 2015/16 budget has been compiled on the basis that the Council will make the following withdrawals from reserves:

	£000
General Fund Reserves	105
Capital Reserves	334
	439

The final amount to be withdrawn from reserves is subject to the final decision of Full Council on 25th February 2015.

The need to withdraw any further funds from the investment portfolio will be kept under review and assessed on a case by case basis with reference to the economic climate at the time.

5.2 Interest Chargeable on Outstanding Amounts Owed to the Council in Relation to the Public Health Act 1936

Where a local authority has incurred expenses in line with the above Act for the repayment of which the owner of the premises in respect of which the expenses were incurred is liable, those expenses, may be recovered by the authority from the person who is the owner of the premises at the date when the works are completed.

A local authority may by order declare any expenses recoverable by it under this Act to be payable with interest by installments within a period not exceeding thirty years, until the whole amount is paid.

The rate of interest chargeable per the act shall be such rate as the authority may determine.

For these purposes the Strategic Lead Finance has elected to use a rate of 4% above base. The reason behind this is as follows:

- It is less than Statutory Interest (base rate plus 8%)
- It should be sufficient to act as a deterrent
- It is in line with other legal agreements
- It is linked to the base rate so would offer protection against interest rate risk

In addition the PWLB annuity rate over a 30 year period is 3.63% and 3.88% for a maturity, so 4% would not be out of line with the PWLB rate for the maximum credit period available under the legislation.

It is recommended that members approve the rate of 4% above base rate in relation to outstanding debt associated with the Public Health Act 1936.

6. Appendices

1. Interest rate forecasts
2. Economic background
3. Current counterparty list
4. The treasury management role of the Section 151 Officer

Appendix 1: Interest Rate Forecasts 2015 - 2018 (provided by Capita Asset Services as at 7 January 2015)

This information has been provided by Capita Asset Services. The following table and commentry gives their central view.

Annual Average %	***Bank Rate %***	***PWLB Borrowing Rates % (including certainty rate adjustment)***		
		5 year	***25 year***	***50 year***
Mar 2015	*0.50*	*2.20*	*3.40*	*3.40*
Jun 2015	*0.50*	*2.20*	*3.50*	*3.50*
Sep 2015	*0.50*	*2.30*	*3.70*	*3.70*
Dec 2015	*0.75*	*2.50*	*3.80*	*3.80*
Mar 2016	*0.75*	*2.60*	*4.00*	*4.00*
Jun 2016	*1.00*	*2.80*	*4.20*	*4.20*
Sep 2016	*1.00*	*2.90*	*4.30*	*4.30*
Dec 2016	*1.25*	*3.00*	*4.40*	*4.40*
Mar 2017	*1.25*	*3.20*	*4.50*	*4.50*
Jun 2017	*1.50*	*3.30*	*4.60*	*4.60*
Sep 2017	*1.75*	*3.40*	*4.70*	*4.70*
Dec 2017	*1.75*	*3.50*	*4.70*	*4.70*
Mar 2018	*2.00*	*3.60*	*4.80*	*4.80*

UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided somewhat but still remains strong by UK standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 1.0% in November, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though *current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.*

The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3. This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by mid 2015.

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

- *Greece: the general election on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strenthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify;*

- *As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. 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 2015/16 and beyond;*

- *Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to* *avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;*

- *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.*

Apendix 2: Economic Background (provided by Capita Asset Services as at 7 January 2015)

***UK**. After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.*

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

***Eurozone (EZ).** The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November 2014, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. It now appears likely that the ECB will embark on full quantitative easing (purchase of EZ country sovereign debt) in early 2015.*

Concern in financial markets for the Eurozone subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout 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 (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some 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 likely to continue 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: *the general election due to take place on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify. 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 which have high unemployment rates. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti austerity policies. Any loss of market confidence in either of the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.*

USA. *The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently forecast that the first increase in the Fed. rate will occur by the middle of 2015.*

China. *Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for many years. There are also concerns that the Chinese leadership has only started to address an unbalanced economy which is heavily over dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.*

Japan. *Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession in Q2 and Q3. The Japanese government already has the highest debt to GDP ratio in the world.*

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data transpires over 2015. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. 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, or the safe haven of bonds.

The overall 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 eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current 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. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur 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 weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an 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, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp 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 larger 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 to current forecasts for UK gilt yields and PWLB rates currently include:

- *Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.*
- *UK strong economic growth is weaker than we currently anticipate.*
- *Weak growth or recession in the UK's main trading partners - the EU, US and China.*
- *A resurgence of the Eurozone sovereign debt crisis.*

- *Recapitalisation of European banks requiring more government financial support.*
- *Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.*

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- *An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government*
- *ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.*
- *The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.*
- *A surge in investor confidence that a return to robust world economic growth is imminent, causing a flow of funds out of bonds into equities.*
- *UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.*

Appendix 3:

Internal Counterparty List 2014-15

Building Societies				
		Total Assets £'000	**Assets > £1 Billion**	**Max Investment £**
1	Nationwide	188,889,000	YES	3,000,000
2	Yorkshire	34,853,000	YES	3,000,000
3	Coventry	27,843,000	YES	3,000,000
4	Skipton	14,054,000	YES	3,000,000
5	Leeds	11,231,000	YES	3,000,000
6	Principality	6,933,000	YES	3,000,000
7	West Bromwich	5,630,000	YES	3,000,000
8	Newcastle	3,677,000	YES	2,000,000
9	Nottingham	3,016,000	YES	2,000,000
10	Cumberland	1,693,000	YES	2,000,000
11	Progressive	1,620,000	YES	2,000,000
12	National Counties	1,261,000	YES	2,000,000
13	Saffron	1,186,000	YES	2,000,000
14	Cambridge	1,159,000	YES	2,000,000
Money Market Funds	CCLA - Public Sector Deposit Fund		AAAmmf	3,000,000

Banks	UK or Irish bank with presence in UK and a short term Fitch rating of F1 or higher.			
UK High Street Banks		**Short Term Fitch Rating**		**Max Investment £**
	Lloyds Banking Group			
	Lloyds TSB	F1		2,000,000
	Bank of Scotland	F1		2,000,000
	Halifax	0		0
	Royal Bank Of Scotland Group			
	Royal Bank of Scotland	F1		2,000,000
	Natwest	F1		2,000,000
	Others			
	Santander UK PLC	F1		2,000,000
	Barclays	F1		2,000,000
	HSBC Bank plc	F1+		2,000,000
	Clydsdale Bank	F1		2,000,000
	Co-op Bank	B		0

Non-UK Banks		Short Term Fitch Rating	LongTerm Fitch Rating	Max Investment £
	Abu Dhabi (U.A.E)			
	National Bank of Abu Dhabi	F1+	AA-	2,000,000
	Australia			
	Australia and New Zealand Banking Group Ltd	F1+	AA-	2,000,000
	Commonwealth Bank of Australia	F1+	AA-	2,000,000
	National Australia Bank Ltd	F1+	AA-	2,000,000
	Westpac Banking Corporation	F1+	AA-	2,000,000
	Canada			
	Bank of Montreal	F1+	AA-	2,000,000
	Bank of Nova Scotia	F1+	AA-	2,000,000
	Canadian Imperial Bank of Commerce	F1+	AA-	2,000,000
	Royal Bank of Canada	F1+	AA	2,000,000
	Toronto Dominion Bank	F1+	AA-	2,000,000
	Finland			
	Nordea Bank Finland plc	F1+	AA-	2,000,000
	Netherlands			
	Cooperatieve Centrale Raiffeisen Boerenleenbank BA (Rabobank Nederland)	F1+	AA-	2,000,000
	Singapore			
	DBS Bank Ltd	F1+	AA-	2,000,000
	United Overseas Bank Ltd	F1+	AA-	2,000,000
	Sweden			
	Svenska Handelsbanken AB	F1+	AA-	2,000,000
	U.S.A			
	Bank of New York Mellon, The	F1+	AA-	2,000,000
	HSBC Bank USA, N.A.	F1+	AA-	2,000,000
	Northern Trust Company	F1+	AA-	2,000,000
	Wells Fargo Bank NA	F1+	AA-	2,000,000
	UK Local, Police and Fire Authorities			3,000,000

Appendix 4: The treasury management role of the Section 151 Officer

The S151 (responsible) officer

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