TYNE & WEAR FIRE AND RESCUE AUTHORITY **Item 4**

AUTHORITY MEETING: 25TH MARCH 2013

SUBJECT: TREASURY MANAGEMENT POLICY AND STRATEGY 2013/2014, INCLUDING PRUDENTIAL 'TREASURY MANAGEMENT' INDICATORS FOR 2013/2014 TO 2015/2016

REPORT OF THE FINANCE OFFICER

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1. Purpose of the Report

1.1 The purpose of this report is to set out the Treasury Management Policy and Strategy (including both borrowing and investment strategies) proposed for 2013/2014 and the Prudential 'Treasury Management' Indicators for 2013/2014 to 2015/2016 for approval.

2. Description of Decision

2.1 The Authority is requested to note that the Governance Committee has already scrutinised the proposed Treasury Management Policy and Strategy Statement for 2013/2014 (including the Treasury Management Prudential Indicators) in line with best practice; and

2.2 The Authority is requested to approve:
- 2013/2014 Annual Treasury Management Policy and Strategy (including specifically the Annual Borrowing and Investment Strategies);
- Prudential 'Treasury Management' Indicators for 2013/2014 to 2015/2016.

3. Treasury Management

3.1 Treasury management is defined as "the management of the 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 Treasury Management function is a specialist service that is carried out by Sunderland City Council on behalf of the Authority.

3.2 Statutory requirements

The Local Government Act 2003 (the Act) and supporting regulations requires the Authority to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Management indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable, these are set out in Appendix 1.

The Act also requires the Authority to adopt a Treasury Management Policy Statement (detailed in Appendix 2) and to set out its Treasury Management Strategy comprising the Authority's strategy for borrowing and the Authority's policies for managing its investments and giving priority to the security and liquidity of those investments (Appendix 3).

The Department of Communities and Local Government issued revised investment guidance which came into effect from 1 April 2010 and the Charted Institute of Public Finance and Accountancy (CIPFA) has updated its Treasury Management in the Public Services Code of Practice in November 2011. Revisions made in the Code of Practice were largely regulatory updates to reflect developments resulting from the Localism Act 2011 and in particular changes to the way that local authority housing finance operate. The Authority adopted the amended CIPFA Code of Practice.

3.3 **CIPFA Code of Practice requirements**

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management has been fully adopted by the Authority.

The primary requirements of the Code are as follows:

1. The Authority will create and maintain, as the cornerstones for effective treasury management:
    - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
    - suitable Treasury Management Practices (TMP's), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

    The content of the policy statement is detailed in Appendix 2 and the TMP's follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Authority. Such amendments which are minor in nature do not result in the Authority deviating from the Code's key principles and requirements.

2. The Authority will receive reports on treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMP's.

3. The Authority delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to this

Committee, and for the execution and administration of treasury management decisions to the Finance Officer, who acts in accordance with the organisation's Policy Statement, TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

4. The Authority has previously nominated the Governance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Treasury Management Strategy for 2013/2014

3.4 The Treasury Management Strategy comprises a Borrowing and an Investment Strategy. These set out the Authority's policies for managing its borrowing and investments and for giving priority to the security and liquidity of investments.

3.5 There are no major changes being proposed to the overall Treasury Management Strategy in 2013/2014 which maintains the prudent approach adopted by the Authority in previous years. Particular areas that inform the strategy include the extent of potential borrowing included in the Authority's capital programme, the availability of borrowing, and the current and forecast world and UK economic position, in particular forecasts relating to interest rates and security of investments.

3.6 The proposed Treasury Management Strategy Statement for 2013/2014 is set out in Appendix 3 and is based upon the views of the Finance Officer, supplemented with market data, market information and leading market forecasts provided by the Authority's treasury adviser, Sector Treasury Services. Although one of the rating agency's has downgraded the UK from it's AAA rating there has been little impact on the UK position which is still regarded as strong and a safe haven for foreign investors. The other two rating agency's have retained their AAA rating for the UK. The Treasury Management Policy and Strategy Statement has been amended to reflect this development.

3.7 The strategy is subject to regular review to ensure compliance to the agreed treasury management strategy and that the strategy adapts to changing financial markets as appropriate. It is pleasing to note that the current average rate of borrowing at 3.51% is low in comparison with other local authorities whilst the current rate earned on investments is higher than the overall benchmark rate. The lead authority, Sunderland City Council, TM performance is also benchmarked with the majority of local authorities and is highly ranked within the top quartiles for both its low average rate of borrowing and also for the rate of return achieved on its investments. Debt rescheduling undertaken by the lead authority in previous years has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. Market conditions are under constant review so that the Authority can take a view on the optimum time to carry out further borrowing or debt rescheduling.

4. **Recommendations**

4.1 To note that the Treasury Management Policy and Strategy Statement for 2013/2014 and associated Prudential Indicators had already been scrutinised by the Governance Committee in line with best practice; and

4.2 To approve the 2013/2014 Annual Treasury Management Policy and Strategy (including specifically the Annual Borrowing and Investment Strategies) and the Prudential 'Treasury Management' Indicators for 2013/2014 to 2015/2016.

5. **Alternative Options**

5.1 No alternatives are submitted for the Authority's consideration

Appendix 1

Prudential 'Treasury Management' Indicators 2013/2014 to 2015/2016

The indicators below relate to Treasury Management (all indicators relating to capital financing have been removed for clarity and can be found in the Capital Programme 2013/2014 including Prudential Indicators for 2013/2014 to 2015/2016 report made to the Authority on 18th February 2013.

P5 In respect of its external debt, it is recommended that the Authority approves the following authorised limits for its total external debt, gross of investments for the next three financial years, and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary. These limits separately identify borrowing from other long-term liabilities such as PFI schemes and finance leases. The Authority is asked to approve these limits and to delegate authority to the Finance Officer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for the authority. Any such changes made will be reported to the Authority at the next meetings following the change.

	Authorised Limit for External Debt			
	2012/2013 £000	**2013/2014 £000**	**2014/2015 £000**	**2015/2016 £000**
Borrowing	28,525	31,206	35,186	36,612
Other long term liabilities	24,032	24,177	24,273	24,342
Total	52,557	55,383	59,459	60,954

The Finance Officer reports that these authorised limits are consistent with the Authority's current commitments, existing plans and the proposals in this report on the Capital Programme for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Finance Officer confirms that they are based on the estimate of most likely, prudent but not worst case scenario, with, in addition, sufficient headroom over and above this, to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes.

In taking its decisions on the Revenue Budget and Capital Programme for 2013/2014, the Authority is asked to note that the authorised limit determined for 2013/2014 of £55.383m, will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

P6 The Authority is also asked to approve the following operational boundary for external debt for the same time period and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary. The proposed operational boundary for external debt is based on the same estimates as the authorised limit but reflects directly the estimate of the most likely, prudent but not worst case scenario level, without the additional headroom included within the authorised limit to allow, for example, for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified.

The Authority is also asked to delegate authority to the Finance Officer, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit set out above.

The operational boundary limit for 2013/14 will be £50.383 million and will be closely monitored and a report will be made to Authority if it is exceeded at any point. It is not anticipated that there will be any issues in terms of remaining within the operational limit for 2013/14.

	Operational boundary for external debt			
	2012/2013 £000	**2013/2014 £000**	**2014/2015 £000**	**2015/2016 £000**
Borrowing	23,525	26,206	30,186	31,612
Other long term liabilities	24,032	24,177	24,273	24,342
Total	47,557	50,383	54,459	55,954

P7 The Authority's actual external debt at 31 March 2012 was £16.213 million (calculated on the basis that all Authority debt is classed as external), comprising £16.163 million borrowing and £0.050 million in respect of other long term liabilities. The Authority includes an element for long term liabilities relating to PFI schemes and finance leases in its calculation of the operational and authorised boundaries to allow flexibility over future financing. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at one point in time and allowances need to be made for cash flow variations.

P9 Sunderland City Council, on the Authority's behalf, has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. The revised Code has therefore been adopted by the Fire and Rescue Authority.

The objective of the Code is to provide a framework for local authority capital finance that will ensure for individual local authorities that:

(a) capital expenditure plans are affordable;
(b) all external borrowing and other long term liabilities are within prudent and sustainable levels;

(c) treasury management decisions are taken in accordance with professional good practice;

and that in taking decisions in relation to (a) to (c) above the local authority is

(d) accountable, by providing a clear and transparent framework.

Further, the framework established by the Code should be consistent with and support:

(e) local strategic planning;
(f) local asset management planning;
(g) proper option appraisal.

In exceptional circumstances the objective of the Code is to provide a framework that will demonstrate that there is a danger of not ensuring the above, so that the Authority can take timely remedial action.

P10 It is recommended that the Authority also adopts the proposed lead authority's upper limit on its fixed interest rate exposures of £235 million in 2013/2014, £295 million in 2014/2015 and £300 million in 2015/2016

P11 It is further recommended that the Authority also adopts the proposed lead authority's upper limit on its variable interest rate exposures of £50 million in 2013/2014, £60 million in 2014/2015 and £60 million in 2015/2016.

P12 It is recommended that the Authority sets upper and lower limits for the maturity structure of its borrowings, consistent with Sunderland City Council's policy, as follows:

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period:

	Upper limit	Lower limit
Under 12 months	50%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	80%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and within 50 years	100%	0%
over 50 years	100%	0%

P13 A maximum maturity limit of £75 million is set for each financial year (2013/2014, 2014/2015 and 2015/2016) for long term investments, (those over 364 days), made by the authority. This gives additional flexibility in undertaking the Treasury Management function. Should any external fund managers be appointed during the year, these limits will be apportioned accordingly. The type of investments to be allowed are detailed in the Annual Investment Strategy (Appendix 3).

Appendix 2

Treasury Management Policy Statement

In line with CIPFA recommendations, the Authority adopted the following Treasury Management Policy Statement, which defines the policies and objectives of its treasury management activities:

- The Authority defines its treasury management activities as: The management of the 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 Authority 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 and any financial instruments entered into to manage these risks..

- The Authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The Authority has an agreed Borrowing and Investment Strategy, the high level policies of which are as follows:

The basis of the agreed Borrowing Strategy is to:
- continuously monitor prevailing interest rates and forecasts;
- secure long-term funds to meet the Authority's future borrowing requirement when market conditions are favourable;
- use a benchmark financing rate of 4.50% for long term borrowing (i.e. all borrowing for a period of one year or more);
- take advantage of debt rescheduling opportunities, as appropriate.

The general policy objective for the Authority in considering potential investments is the prudent investment of its treasury balances.
- the Authority's investment priorities in order of importance are:
  1) The security of capital
  2) The liquidity of its investments and then,
  3) The Authority aims to achieve the optimum yield on its investments but this is commensurate with the proper levels of security and liquidity

- the Authority has a detailed Lending List and criteria must be observed when placing funds – these are determined using expert TM advice, view of money market conditions and using detailed rating agency information as well as using our own market intelligence.
- Limits are also placed on the amounts that can be invested with individual and grouped financial institutions based on the Lending List and detailed criteria

The Authority re-affirms its commitment to the above Treasury Management Policy Statement .

Appendix 3

Treasury Management Strategy Statement for 2013/2014

1. **Introduction**

1.1 The Local Government Act 2003 and subsequent guidance requires the Authority to set out its Treasury Management Strategy for Borrowing and to prepare an Annual Investment Strategy. This sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2013/2014 is set out below and is based upon the Finance Officer's views on interest rates, supplemented with leading market forecasts and other financial data available and advice provided by the Authority's treasury adviser, Sector Treasury Services.

1.2 The treasury management strategy covers:

A. Borrowing Policy and Strategy

- treasury limits for 2013/2014 to 2015/2016
- current treasury management position
- the borrowing requirement 2013/2014
- prudential and treasury management indicators for 2013/2014 to 2015/2016
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling

B. Annual Investment Policy and Strategy

- Investment policy and objectives
- the investment strategy
- investment types
- investments defined as capital expenditure
- investment limits
- provision for credit related losses
- creditworthiness policy
- monitoring of credit ratings
- past performance and current position
- outlook and proposed investment strategy
- external fund managers
- policy on use of external service providers

2. Borrowing Policy and Strategy

2.1 Treasury Limits for 2013/2014 to 2015/2016

It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Authority 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 Authority 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 is ‘acceptable’.

Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is set, on a rolling basis, for the forthcoming financial year and two successive financial years and details can be found in Appendix 1 (P5) of this report. The Authority is asked to approve these limits and to delegate authority to the Finance Officer, within the total limit for any individual year, to action movement between the separately agreed limits for borrowing and other long term liabilities where this would be appropriate. Any such changes made will be reported to the Authority at their next meetings following the change.

Also, the Authority is asked to approve the Operational Boundary Limits which are included in the Prudential Indicators in Appendix 1 (P6). This operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified and the Authority is also asked to delegate authority to the Finance Officer, within the total operational boundary for any individual year, to action movement between the separately agreed figures for borrowing and other long-term liabilities, in a similar fashion to the authorised limit.

2.2 Current Treasury Management Position

2.2.1 Interest Rates 2012/2013

The Bank of England Base Rate has remained at 0.50% since 5th March 2009 and Economists are united in their forecasts for the Bank Base Rate, with no change to the current 0.5% predicted until after the December 2014 quarter at the earliest. PWLB rates and bond yields remain extremely unpredictable and there are still exceptional levels of volatility which are highly correlated to the sovereign debt crisis and to political developments in the Eurozone. This uncertainty is expected to continue into the medium term.

The government announced in the March 2012 budget plans to introduce a 0.20% discount on PWLB loans under the prudential borrowing regime for those authorities that provided 'improved information and transparency on their locally determined long-term borrowing and associated capital spending plans' and who successfully applied and were eligible for the lower rate. Sunderland City Council successfully applied to access loans at the lower PWLB certainty rate, which came into effect on 1st November 2012 and eligibility lasts until 31st October 2013 when authorities must reapply to access the PWLB certainty rate for the following 12 months.

Loan Type	31st March 2012 %	31st December 2012* %	Difference %
7 Day Notice	0.46	0.36	(0.10)
1 Month	0.57	0.37	(0.20)
PWLB – 1 Year	1.28	1.03	(0.25)
5 Years	2.05	1.70	(0.35)
10 Years	3.21	2.64	(0.57)
25 Years	4.32	3.87	(0.45)
50 Years	4.36	4.03	(0.33)

*Rates at 31/12/12 take into account a 0.2% discount to PWLB rates available to eligible authorities that came into effect on 1st November 2012.

2.2.2 **Long Term Borrowing 2012/2013**

The Authority's strategy for 2012/2013 is to adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow and to respond to any changing circumstances to seek to secure benefit for the Authority. A benchmark financing rate of 4.50% for long-term borrowing was set in the Treasury Management Policy and Strategy Statement for 2012/2013. Due to high levels of volatility in the financial markets, with borrowing rates still forecast to remain low over the short term, no new borrowing has been undertaken in the current financial year up to 16th January 2013, and no debt rescheduling has been undertaken as rates have not been considered sufficiently favourable.

There are currently nine market, Lender's Option / Borrower's Option (LOBO's), loans totalling £39.5 million. The lender has the option to alter the rate on these loans at set intervals and these can either be accepted at the new rate or be repaid without penalty. The following table shows the LOBO's that were subject to a potential rollover in this financial year but no changes have been received.

Roll Over Dates	Lender	Amount £m	Rate %	Roll Over Periods
21/04/2012 and 21/10/2012	Barclays	5.0	4.50	Every 6 months
29/09/2012	Dexia	5.0	4.32	every 3 years
03/02/2013	Dexia	5.0	4.37	every 3 years
22/02/2013	Dexia	5.0	4.38	every 3 years
Total		**20.0**		

2.2.3 Current Portfolio Position

The treasury portfolio position for Sunderland City Council which the Fire and Rescue Authority forms part of, at 28th February 2013 comprised:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	142.9		
	Market (LOBO's)	24.5		
	Other	0.3	167.7	3.90
Variable Rate Funding	PWLB	0.0		
	Market (LOBO's)	15.0		
	Temporary/ Other	29.2	44.2	2.02
Total Borrowing			**211.9**	3.51
Total Investments	In House-short term*		**223.1**	1.90
	Long term**		**14.9**	8.60
	Total Investments		**238.0**	
Net Position			**26.1**	

*The total investments figure includes monies invested on behalf of the North Eastern Local Enterprise Partnership for whom Sunderland City Council is the accountable body.
** This relates to a specific investment for Sunderland City Council

Currently there is an excess of £26.1 million representing the difference between gross debt and total investments. However this position is expected to change over the next few years as both the lead authority and the Authority have to manage their finances with significantly less government funding. This could impact in the form of increased borrowing and reductions to reserves, with the result that the net borrowing position will increase.

There are a number of risks and benefits associated with having both a large amount of debt whilst at the same time having a considerable amount of investments.

Benefits of having a high level of investments are;

- liquidity risk – having a large amount of investments means that the Authority is at less of a risk should money markets become restricted or borrowing less generally available, this mitigates against liquidity risk;
- interest is received on investments which helps the Authority to address its Strategic Priorities;

§ the Authority has greater freedom in the timing of its borrowing as it can afford to wait until the timing is right rather than be subject to the need to borrow at a time when interest rates are not advantageous.

Risks associated with holding a high level of investments are;

§ the Counterparty risk – institutions cannot repay the Authority investment placed with them;

§ interest rate risk – the rate of interest earned on the investments will be less than that paid on debt, thus causing a loss to the Authority.

The Authority has mitigated these risks by formulating its Treasury Management Investment Strategy and by detailed monitoring of counterparties through its borrowing and investment strategies and treasury management working practices and procedures.

2.3 **Borrowing Requirement 2013/2014**

The borrowing requirement for Sunderland City Council which the Fire and Rescue Authority also forms part of, is as follows:

		2013/14 £m	**2014/15 £m**	**2015/16 £m**
1.	Capital Borrowing (potential)	44.4	42.2	14.6
2.	Replacement borrowing (PWLB)	5.0	10.0	0.0
3.	Replacement borrowing (Market)	0.0	0.0	0.0
4.	Market LOBO replacement (potential)	10.0	19.5	20.0
TOTAL – KNOWN (2+3)		**5.0**	**10.0**	**0.0**
TOTAL – POTENTIAL (1+4)		**54.4**	**61.7**	**34.6**

2.4 **Prudential and Treasury Management Indicators for 2013/2014 – 2015/2016**

Prudential and Treasury Management Indicators (as set out in Appendix 1, P5 - P7 and P9 – P13) are a requirement of the CIPFA Prudential Code and are relevant for the purposes of setting an integrated treasury management strategy and to ensure that treasury management decisions are taken in accordance with good professional practice.

The Authority is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on 20th November 2002 and the revised 2009 Code was adopted by the Authority on 22nd March 2010. The Code has been revised in November 2011 and the Authority must re-affirm its full adherence to the code annually (as set out in Appendix 2).

2.5 **Prospects for Interest Rates**

The Authority's treasury advisors are Sector Treasury Services and part of their service is to assist the Authority to formulate a view on interest rates. A number of current City forecasts for short term (Bank Rate) and longer fixed interest rates are set out in Appendix 4. The following gives the Sector Treasury Services Bank Rate forecast for the next 4 financial years:

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

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate. A detailed view of the current economic background is contained within Appendix 5 to this report. The position will be closely monitored to ensure the Authority takes appropriate action as necessary under either scenario.

2.6 **Borrowing Strategy**

2.6.1 **Borrowing rates**

The Sector forecast in respect of interest rates for loans charged by the PWLB is as follows: -

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

A more detailed forecast from Sector is included in Appendix 4.

The main sensitivities of the forecast are likely to be;

- if it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate borrowing will be undertaken whilst interest rates are still relatively cheap.

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

In conjunction with the Authority's treasury advisers, the Authority will monitor both the prevailing interest rates and the market forecasts. With long-term interest rate forecasts set to remain around their current levels the Finance Officer, taking into account the advice of the Authority's treasury adviser considers a benchmark financing rate of 4.50% for any further long-term borrowing for 2013/2014 to be appropriate.

Consideration will be given to various options, including utilising some investment balances to fund the borrowing requirement in 2013/2014. The need to adapt to changing circumstances and revisions to profiling of capital expenditure is required, and flexibility needs to be retained to adapt to any changes that may occur.

The Finance Officer, taking advice from the Authority's treasury advisers will continue to monitor rates closely, and whilst implementing the borrowing strategy, will adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow, wherever possible.

2.7 Policy on borrowing in advance of need

The Authority will not borrow more than or in advance of its needs purely to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be assessed within the relevant Capital Financing Requirement calculations/estimates and will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.

Risks associated with any borrowing in advance of activity will be subject to prior appraisal and borrowing undertaken will be reported to Authority as part of agreed treasury management reporting arrangements.

2.8 Debt Rescheduling

The reasons for any rescheduling of debt will include:

- the generation of cash savings at minimum risk;
- in order to help fulfil the Treasury Management Strategy; and
- in order to enhance the balance of the long-term portfolio (by amending the maturity profile and/or the balance of volatility).

In previous years, debt rescheduling has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. For example, since November 2008 the lead authority has rescheduled debt worth £59.5 million with an ongoing reduction in interest costs of just under £1.0 million per annum. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB debt restructuring is much less attractive than it was before both of these measures were introduced. Consideration will also be given to other options where interest savings may be achievable by using LOBO (Lenders Option Borrowers Option) loans, and / or other market loans, in rescheduling exercises rather than solely using PWLB borrowing as the source of replacement financing but this would only be the case where this would represent best value to the Authority.

The latest interest rate projections for 2013/2014 show short term borrowing rates will be considerably cheaper than longer term rates and as such there may be potential for some opportunities to generate savings by switching from long term debt to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred), 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.

The Authority is keeping a watching brief on market conditions in order to secure further debt rescheduling when, and if, appropriate opportunities arise. The timing of all borrowing and investment decisions inevitably includes an element of risk, as those decisions are based upon expectations of future interest rates. The policy to date has been very firmly one of risk spread and this prudent policy will be continued.

Any rescheduling undertaken will be reported to the Authority, as part of the agreed treasury management reporting arrangements.

3. **Annual Investment Policy and Strategy**

3.1 **Investment Policy and Objectives**

When considering its investment policy and objectives, the Authority has taken regard to the Department of Communities and Local Government's (CLG) Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The Authority's investment objectives are: -

(a) the security of capital, and
(b) the liquidity of its investments.

The Authority also aims to achieve the optimum return on its investments but commensurate with proper levels of security and liquidity. The risk appetite of the Authority is regarded as low in order to give priority to security of its investments.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Authority will not engage in such activity.

3.2 **Investment Strategy**

This Strategy sets out:

- the procedures for determining the use of each class of investment (advantages and associated risk), particularly if the investment falls under the category of "non-specified investments";
- the maximum periods for which funds may be prudently committed in each class of investment;
- the amount or percentage limit to be invested in each class of investment;
- whether the investment instrument is to be used by the lead authority's in-house officers and/or by the appointed external fund managers, (if used); and, if non-specified investments are to be used in-house, whether prior professional advice is to be sought from the Authority's treasury advisers;
- the minimum amount to be held in short-term investments (i.e. an investment which the Authority may require to be repaid or redeemed within 12 months of making the investment).

3.3 **Investment Types**

The Authority is allowed to invest in two types of investment, namely Specified Investments and Non-specified Investments.

Specified Investments are those investments that are for a period of less than one year, are not classed as capital expenditure, and are placed with high credit rated counterparties.

Non-specified Investments are any investments which are not classified as specified investments. As the Authority only uses high credit rated counterparties this means in effect that any investments placed with those counterparties for a period of one year or more will be classed as Non-specified Investments. The Authority will not invest in any type of investment that will be classed as capital expenditure (see 3.4 below).

The type of investments to be used by the in-house team will be limited to term deposits, interest bearing accounts, and Money Market Funds, treasury bills and gilt edged securities and will follow the criteria as set out in Appendix 6.

3.4 **Investments Defined as Capital Expenditure**

The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments have to be funded out of capital or revenue resources and are classified as ‘non-specified investments’.

A loan or grant by this Authority to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by the Authority. It is therefore important for the Authority to clearly identify if the loan has been made for policy reasons or if it is an investment for treasury management purposes. The latter will be governed by the framework set by the Authority for ‘specified’ and ‘non-specified’ investments.

The Authority will not use (or allow any external fund managers it may appoint to use) any investment which will be deemed as capital expenditure.

3.5 **Investment Limits**

One of the recommendations of the Code is that local authorities should set limits for the amounts of investments that can be placed with institutions by country, sector and group. These limits are applied in the lead authority’s Counterparty criteria set out in Appendix 6.

The minimum amount of overall investments that the will be held in short-term investments (less than one year) is £50 million. As the lead authority has decided to restrict most of its investments to term deposits, it will maintain liquidity by having a minimum of 30% of these short-term investments maturing within 6 months.

A maximum limit of £75 million is to be set for in-house non-specified investments over 364 days up to a maximum period of 2 years. This amount has been calculated by reference to the total cash flows available and projected, including the potential use of earmarked reserves. The Finance Officer will monitor long-term investment rates and identify any investment opportunities if market conditions change.

3.6 **Provisions for Credit Related Losses**

If any of the investments appear at risk of loss due to default, (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates), then the lead authority will make revenue provision of an appropriate amount in accordance with proper accounting practice or any prevailing government regulations, if applicable. This position has not occurred and the lead authority mitigates this risk with its prudent investment policy.

3.7 **Creditworthiness policy**

The creditworthiness policy adopted by the lead authority takes into account not only the credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also, available market data and intelligence such as Credit Default Swap levels and share prices, the level of government support to financial institutions and advice from its Treasury Management advisors.

Set out in Appendix 6 is the detailed criteria that will be used, subject to approval, in determining the level of investments that can be invested with each counterparty or institution. Where a counterparty is rated differently by any of the 3 rating agencies, the lowest rating will be used to determine the level of investment.

3.8 **Monitoring of Credit Ratings**

- All credit ratings are monitored on a daily basis. The Authority has access to all three credit ratings agencies and is alerted to changes through its use of the Sector Treasury Services credit worthiness service.

- If a counterparty's rating is downgraded with the result that it no longer meets the Authority's minimum criteria, the Authority will cease to place funds with that counterparty. The Authority will also immediately inform its external fund manager(s), if used, to cease placing funds with that counterparty.

- If a counterparty's rating is downgraded with the result that their rating is still sufficient for the counterparty to remain on the Approved Lending List, then the counterparty's authorised investment limit will be reviewed accordingly. A downgraded credit rating may result in the lowering of the counterparty's investment limit and vice versa. The Authority will also immediately inform its external fund manager(s), if used, of any such change(s).

Should fund managers be employed by the Authority, the Authority will establish with its fund manager(s) their credit criteria and the frequency of their monitoring of credit ratings so as to be satisfied as to their adherence to the Authority's policy.

Moody's, one of the 3 major ratings agencies, has downgraded the UK's AAA sovereign rating by one notch and classified this at a stable outlook. They previously warned that this could happen if Government policy were to change, or was seen to be failing to achieve its desired outcome (the latter being the main reason for the downgrade as prospects for economic recovery are much slower than originally estimated). As the UK Government AAA sovereign rating has been amended the Authority's Investment Strategy and Lending List criteria has been reviewed and necessary changes are included in the Treasury Management Policy and Strategy Statement.

3.9 **Past Performance and Current Position**

During 2012/2013 the Authority did not employ any external fund managers, all funds being managed by the in-house team. The performance of the fund managed by Sunderland City Council's in-house team is shown below and compares this with the relevant benchmarks and performance from the previous year:

	2011/12 Return %	**2011/12 Benchmark** %	**To Date 2012/13 Return** %	**To Date 2012/13 Benchmark** %
Performance	0.80	0.37	0.80	0.43

During 2013/2014 the Authority will continue to review the optimum arrangements for the investment of its funds whilst fully observing the investment strategy in place. The Authority uses the 7 day London Interbank Bid (LIBID) rate as a benchmark for its investments. The performance of the Authority compared well with other local authorities and is in the top quartile.

3.10 **Outlook and Proposed Investment Strategy**

Based on its cash flow forecasts, the Authority together with the City Council anticipates its fund balances in 2013/2014 are likely to range between £100 million and £250 million. This represents a cautious approach and provides for funding being received in excess of the level budgeted for, and also for unexpected and unplanned levels of capital underspending in the year or re-profiling of spend into future years. In 2013/2014, with short-term interest rates forecast to be materially below long-term rates, it is possible that some investment balances may be used to fund some long-term borrowing or used for debt rescheduling. Such funding is wholly dependent upon market conditions and will be assessed and reported to the Authority if and when the appropriate conditions arise.

The Authority is not committed to any investments, which are due to commence in 2013/2014, (i.e. it has not agreed any forward deals).

Activities likely to have a significant effect on investment balances are:

- Capital expenditure during the financial year, (dependent upon timing), will affect cash flow and short term investment balances;
- Any re-profiling of capital expenditure from, and to, other financial years will also affect cash flow, (no re-profiling has been taken into account in current estimates);
- Any unexpected capital receipts or income;
- Timing of new long-term borrowing to fund capital expenditure;
- Possible funding of long-term borrowing from investment balances (dependent upon appropriate market conditions).

The Finance Officer, in conjunction with the Authority's treasury adviser Sector Treasury Services, and taking into account the minimum amount to be maintained in short-term investments, will continue to monitor investment rates closely and to identify any appropriate investment opportunities that may arise.

It is proposed that delegated authority continues to be given to the Finance Officer to vary the Lending List Criteria and Lending List itself should circumstances dictate, on the basis that changes be reported to the Authority retrospectively, in accordance with normal Treasury Management reporting procedures.

3.11 **External fund managers**

At present the lead authority does not use external fund managers.

Should the Authority appoint any external fund managers in the future, they will have to agree to strict investment limits and investment criteria. These external fund managers will work to the following parameters:

- The institutions on the Approved Lending list of the external manager must correspond to those agreed with the lead authority (i.e. only institutions on the Approved Lending List to be included as shown in Appendix 7);
- they will be allowed to invest in term deposits, Certificates of Deposit (CD's) and government gilt securities;
- An investment limit of £3 million per institution (per manager);
- A maximum limit of 50% fund exposure to government gilts;
- A maximum proportion of the fund invested in instruments carrying rates of interest for periods longer than 364 days shall not exceed 50%. It is proposed to only recommend the use of fixed term deposits up to a maximum of 2 years.

3.12 **Policy on the use of external service providers**

The Authority uses Sector as its external treasury management advisers. The Authority recognises that responsibility for treasury management decisions remains with the Authority 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. The Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review.

4. **Scheme of delegation**

4.1 The Treasury Management Strategy Statement has been prepared in accordance with the revised Code. Accordingly, the Authority's Treasury Management Strategy (TMS) is approved annually by the Authority and the Authority now receive, as a minimum, a mid-year TMS report and an annual Treasury Management outturn report for the previous year by no later than the 30th September of the following year. In addition quarterly reports are made to the Authority and the Governance Committee and monitoring reports are reviewed by members in both executive and scrutiny functions respectively. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The Authority has the following reporting arrangements in place in accordance with the requirements of the Code – these are summarised in the table as follows:

Area of Responsibility	**Authority/ Committee/ Officer**	**Frequency**
Treasury Management Policy Statement (revised)	Full Authority	Reaffirmed annually and updated as appropriate
Treasury Management Strategy / Annual Investment Strategy	Full Authority	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy – mid year report	Full Authority	Mid year

Area of Responsibility	Authority/ Committee/ Officer	Frequency
Treasury Management Strategy / Annual Investment Strategy – updates or revisions at other times	Full Authority	As appropriate
Annual Treasury Management Outturn Report	Full Authority	Annually by 30/9 after the end of the financial year
Treasury Management Monitoring Reports	Finance Officer	Monthly
Treasury Management Practices	Finance Officer	Annually
Scrutiny of Treasury Management Strategy	Governance Committee	Annually before Full Authority
Scrutiny of Treasury Management Performance	Governance Committee	Quarterly

5. **The Treasury Management Role of the Section 151 Officer**

5.1 The Finance Officer is the Authority's Section 151 Officer and has specific delegated responsibility in the Authority's Constitution to manage the borrowing, financing, and investment requirements of the Authority in accordance with the Treasury Management Policy agreed by the Authority. This includes;

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

Appendix 4

Interest Rate Forecasts

Introduction
The data set out overleaf shows a variety of forecasts published by Sector Treasury Services, Capital Economics (an independent forecasting consultancy) and UBS (which represents summarised figures drawn from the population of all major City banks and academic institutions).

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. Individual Forecasts

Sector's Interest Rate View	Now	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.40%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%	1.40%	1.70%	1.90%
6 Month LIBID	0.56%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%	1.60%	1.90%	2.20%
12 Month LIBID	0.92%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%	1.80%	2.10%	2.40%
5yr PWLB Rate	1.66%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
10yr PWLB Rate	2.64%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
25yr PWLB Rate	3.88%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
50yr PWLB Rate	4.04%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
Bank Rate															
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate															
Sector's View	1.66%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
UBS	1.66%	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.66%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	-	-	-	-	-
10yr PWLB Rate															
Sector's View	2.64%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
UBS	2.64%	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	-	-	-	-	-
Capital Economics	2.64%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	-	-
25yr PWLB Rate															
Sector's View	3.88%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
UBS	3.88%	4.00%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	-	-	-	-	-
Capital Economics	3.88%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-	-	-	-	-
50yr PWLB Rate															
Sector's View	4.04%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
UBS	4.04%	4.10%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	-	-	-	-	-
Capital Economics	4.04%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

2. Survey of Economic Forecasts

HM Treasury January 2013

The current Q4 2012 and 2013 base rate forecasts are based from samples of both City and non-City forecasters included in the HM Treasury December 2012 report.

BANK RATE FORECASTS	quarter ended		annual average Bank Rate		
	Q4 2012	Q4 2013	ave. 2014	ave. 2015	ave. 2016
Median	0.49%	0.53%	0.74%	1.44%	2.04%
Highest	0.50%	1.50%	1.60%	4.02%	3.60%
Lowest	0.25%	0.25%	0.25%	0.50%	0.50%

Appendix 5

Economic Background

1.1. Global economy

The Eurozone debt crisis has continued to depress growth in most countries within the World. This has impacted on the UK economy which is unlikely to grow significantly in 2012 and is creating problems that may hamper recovery in 2013. Quarter 2 of 2012 was the third quarter of contraction in the UK economy and this recession is the worst and slowest recovery of any of the five recessions experienced since 1930. A return to growth of around 1% in quarter 3 is unlikely to prove anything more than a temporary improvement before a return to weak, or negative, growth in quarter 4.

Eurozone

The Eurozone sovereign debt crisis has abated following the European Central Bank's (ECB) pledge to buy unlimited amounts of bonds of countries which require a bailout. The immediate target for this action was Spain which continues to prevaricate on making such a request (for a national bailout) and so surrendering its national sovereignty to IMF supervision. However, the situation in Greece is heading towards a critical point as the Eurozone 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 experts still view a Greek exit from the Euro as inevitable as total debt now looks likely to reach 190% of GDP (in the UK the comparable figure is 68%) i.e. unsustainably high, unless the Eurozone were to accept a major write down of Greek debt. The possibility of a write down has now been raised by the German Chancellor, but not until 2014-15, and provided the Greek annual budget is in balance.

Sentiment in financial markets has improved considerably since this ECB action and the 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.

United States

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 with large amounts of quantitative easing (QE) combined with a commitment to a continuation of very 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 to economic growth discouraging business from spending on investment and increasing employment more significantly in case there is a sharp contraction in the economy if not resolved. However, the housing market does look as if it has reached the bottom and house prices are now on the up.

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

1.2 UK economy
The Government's austerity measures, aimed at getting the public sector deficit into order, have now had to be extended (in the autumn statement) over a longer period than the original four years now into 2017/18. Achieving this new extended time frame will still be dependent on the UK economy returning to a reasonable pace of growth towards the end of this period. It was important for the Government to carry out these measures to retain investor confidence in the UK.

Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is still seen as a safe haven from Eurozone debt even though Moody's has downgraded the UK's AAA rating. There is little evidence that consumer confidence is recovering or that the manufacturing sector is picking up. On the positive side, growth in the services sector 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 time to make a significant impact. Finally, the housing market remains weak and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth
Economic growth has remained flat 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 short-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 has had it's AAA sovereign rating downgraded by one of the three major ratings agencies. The credit rating agencies have been carefully monitoring the rate of growth in the economy and disappointing performance in this area has led to a concern that the plans to contain the growth in the total amount of Government debt will take longer than expected.

Although the UK AAA rating has been downgraded (which most experts anticipated as inevitable), it has had very little effect as the UK is still seen as a safe haven for foreign investors.

1.3 Economic Forecast
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 Greek government was unable to eliminate the annual budget deficit and the costs of further support were to be viewed as being 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, The Councils Treasury Advisers, 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 UK credit rating downgrade.

Lending List Criteria **Appendix 6**

Counterparty Criteria

The lead Authority takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisors.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

Fitch / S&P's Long Term Rating	Fitch Short Term Rating	S&P's Short Term Rating	Moody's Long Term Rating	Moody's Short Term Rating	Maximum Deposit £m	Maximum Duration
AAA	F1+	A1+	Aaa	P-1	110	2 Years
AA+	F1+	A1+	Aa1	P-1	90	2 Years
AA	F1+	A1+	Aa2	P-1	40	364 days
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	20	364 days
A+	F1	A-1	A1	P-1	10	364 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	10	364 days
A-	F1 / F2	A-2	A3	P-1 / P-2	5	6 months
Local Authorities (limit for each local authority)					30	2 years
UK Government (including debt management office, gilts and treasury bills)					90	2 years
Money Market Funds Maximum amount to be invested in Money Market Funds is £80 million with a maximum of £40 million in any one fund.					80	Liquid Deposits
Local Authority controlled companies (#duration limited to 20 years in accordance with Capital Regulations)					20	# 20 years

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AA+ will be applied to that institution to determine the amount the Council can place with that institution for a maximum period of 2 years.

Where any banks / building societies are part of the UK Government's Credit Guarantee scheme (marked with * in the Approved Lending List), these counterparties will have an AA rating applied to them thus giving them a credit limit of £40 million for a maximum period of 364 days

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above, these new limits are as follows:

Appendix 6 (continued)

Country Limit
It is proposed that only countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £40 million which can be invested in other countries provided they meet the above criteria. A separate limit of £350 million will be applied to the United Kingdom and is based on the fact that the government has done and is willing to take action to protect the UK banking system.

Country	**Limit £m**
UK	350
Non UK	40

Sector Limit
The Code recommends a limit be set for each sector in which the Authority can place investments. These limits are set out below:

Sector	**Limit £m**
Central Government	350
Local Government	350
UK Banks	350
UK Building Societies	150
Money Market Funds	50
Foreign Banks	40

Group Limit
Where institutions are part of a group of companies e.g. Lloyds Banking Group, Santander and RBS, then total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. This will apply provided that:

- the government's guarantee scheme is still in place;
- the UK continues to have a sovereign credit rating of AA+; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix 7

Approved Lending List **Appendix 7**

	Fitch				Moody's			Standard & Poor's			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term	Limit £m	Max Deposit Period
UK	AAA				Aa1			AAA		350	2 years
Lloyds Banking Group (see Note 1)										**Group Limit 90**	
Lloyds Banking Group plc	A	F1	bbb	1	A3	-	-	A-	A-2	90	2 years
Lloyds TSB Bank Plc	A	F1	bbb	1	A2	P-1	C-	A	A-1	90	2 years
Bank of Scotland Plc	A	F1	-	1	A2	P-1	D+	A	A-1	90	2 years
Royal Bank of Scotland Group (See Note 1)										**Group Limit 90**	
Royal Bank of Scotland Group plc	A	F1	bbb	1	Baa1	P-2	-	A-	A-2	90	2 years
The Royal Bank of Scotland Plc	A	F1	bbb	1	A3	P-2	D+	A	A-1	90	2 years
National Westminster Bank Plc	A	F1	-	1	A3	P-2	D+	A	A-1	90	2 years
Ulster Bank Ltd	A-	F1	ccc	1	Baa2	P-2	D-	BBB+	A-2	90	2 years
Santander Group *										**Group Limit 40**	
Santander UK plc	A	F1	a	1	A2	P-1	C-	A	A-1	40	364 days
Cater Allen	-	-	-	-	-	-	-	-	-	40	364 days
Barclays Bank plc *	A	F1	a	1	A2	P-1	C-	A+	A-1	40	364 days
HSBC Bank plc *	AA-	F1+	a+	1	Aa3	P-1	C	AA-	A-1+	40	364 days

Appendix 7(continued)

	Fitch			Moody's				Standard & Poor's			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term	Limit £m	Max Deposit Period
Nationwide BS *	A+	F1	a+	1	A2	P-1	C	A+	A-1	40	364 days
Standard Chartered Bank *	AA-	F1+	aa-	1	A1	P-1	B-	AA-	A-1+	40	364 days
Clydesdale Bank / Yorkshire Bank **/***	A	F1	bbb	1	A2	P-1	C-	BBB+	A-2	0	
Co-Operative Bank Plc	BBB +	F2	bbb+	3	A3	P-2	C-	-	-	0	
Virgin Money ***	BBB	F3	bbb	5	-	-	-	BBB+	A-2	0	
Top Building Societies (by asset value)											
Nationwide BS (see above)											
Yorkshire BS ***	BBB +	F2	bbb+	5	Baa2	P-2	C-	A-	A-2	0	
Coventry BS	A	F1	a	5	A3	P-2	C	-	-	5	6 Months
Skipton BS ***	BBB -	F3	bbb-	5	Ba1	NP	D+	-	-	0	
Leeds BS	A-	F2	a-	5	A3	P-2	C	-	-	5	6 Months
West Bromwich BS ***	-	-	-	-	B2	NP	E+	-	-	0	
Principality BS ***	BBB +	F2	bbb+	5	Ba1	NP	D+	-	-	0	
Newcastle BS ***	BB+	B	bb+	5	-	-	-	-	-	0	
Nottingham BS ***	-	-	-	-	Baa2	P-2	C-	-	-	0	
Foreign Banks have a combined total limit of £40m											
Australia	AAA	-	-	-	Aaa	-	-	AAA		40	364 Days
National Australia Bank	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	20	364 Days
Australia and New Zealand Banking Group Ltd	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	20	364 Days

Appendix 7(continued)											
	Fitch				**Moody's**			**Standard & Poor's**			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term	Limit £m	Max Deposit Period
Commonwealth Bank of Australia	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	20	364 Days
Westpac Banking Corporation	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	20	364 Days
Canada	AAA				Aaa			AAA		40	364 Days
Bank of Nova Scotia	AA-	F1+	aa-	1	Aa1	P-1	B	A+	A-1	20	364 Days
Royal Bank of Canada	AA	F1+	aa	1	Aa3	P-1	C+	AA-	A-1+	20	364 Days
Toronto Dominion Bank	AA-	F1+	aa-	1	Aaa	P-1	B+	AA-	A-1+	20	364 Days
Money Market Funds										80	Liquid Deposits
Prime Rate Stirling Liquidity	AAA							AAA		40	Liquid
Insight Liquidity Fund					AAA			AAA		40	Liquid
Ignis Sterling Liquidity	AAA							AAA		40	Liquid

Notes

Note 1 **Nationalised / Part Nationalised**
The counterparties in this section will have the UK Government's AA+ rating applied to them thus giving them a revised credit limit of £90 million

* Banks / Building Societies which are part of the UK Government's Credit Guarantee scheme. The counterparties in this section will have an AA rating applied to them thus giving them a revised credit limit of £40 million for a maximum period of 364 days

** The Clydesdale Bank (under the UK section) is owned by National Australia Bank

*** These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the FSA is classed as a UK bank for the purposes of the Approved Lending List.

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