ANNEX O

MILTON KEYNES COUNCIL

TREASURY MANAGEMENT STRATEGY

2014/15
TO
2018/19

Content Page

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1 INTRODUCTION

1.1 Background

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

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

1.1.3 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

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

1.2 Reporting Requirements

1.2.1 The Council is required to receive and approve, as a minimum, three main reports each year (four will be reported by this Council as set out below), which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by Cabinet.

1.2.2 **Treasury Management Strategy (This report)** – This report covers:

- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised); and
- an investment strategy (the parameters on how investments are to be managed).

1.2.3 **Prudential and Treasury Indicators Report (As part of the Budget Report elsewhere on this agenda)** - This report covers:

- the capital plans (including prudential indicators);
- the treasury indicators relevant to this report.

1.2.4 **A Mid Year Treasury Management Report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision (This Council currently provides quarterly updates).

1.2.5 **An Annual Treasury Report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.3 Treasury Management Strategy for 2014/15

The strategy for 2014/15 covers two main areas:

Capital Issues:

- the capital plans and the prudential indicators;
- the MRP strategy*.*

Treasury management Issues:

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

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

2 CAPITAL PRUDENTIAL INDICATORS FOR 2014/15 – 2018/19

2.1 Context

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

2.1.2 Major items of capital expenditure (provisional) within this planning horizon and included in the prudential indicators calculations are;

- investment in infrastructure assets;
- a new waste processing facility.

2.1.3 The Prudential and Treasury Indicators are to be set alongside the overall budget setting process in February. Once set, those indicators will be applied in the context of all treasury management decisions.

2.2 Minimum Revenue Provision (MRP)

2.2.1 The Council is required to pay off an element of the accumulated General Fund borrowing requirement used to 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).

2.2.2 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 approach set out in Appendix B.

3 TREASURY MANAGEMENT STRATEGY

3.1 Context

3.1.1 The Council's capital expenditure plans are to be set out in the Capital Programme as part of the overall budget setting process. 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 will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. This report has been prepared alongside the Prudential Indicators report to provide an integrated treasury strategy.

3.2 Current Portfolio Position

3.2.1 The Council's treasury position at 31st March 2013 and forward projections are summarised below. The table shows the actual external debt (the treasury operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), and any over or under borrowing.

Table 1 – Current Portfolio Position

£m	2012/13 Actual	2013/14 Forecast	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
External debt							
External borrowing at 1 April	453.564	448.371	431.913	505.944	522.638	550.392	578.053
Repayment of borrowing during year	(10.000)	(18.000)	(21.123)	(13.464)	(2.408)	(2.505)	(7.607)
New borrowing *	0.000	0.000	95.000	30.000	30.000	30.000	0.000
Other borrowing – tariff cashflow	4.807	1.542	0.154	0.158	0.162	0.166	0.170
*Other long-term liabilities (OLTL) ** *	*1.792*	*1.942*	*0.907*	*0.007*	*0.000*	*0.000*	*0.000*
External debt at 31st March (1)	**450.163**	**433.855**	**506.851**	**522.645**	**550.392**	**578.053**	**570.616**
Capital Financing Requirement	**535.485**	**531.337**	**544.682**	**540.994**	**668.538**	**664.996**	**663.366**
Under / (over) borrowing	***85.322***	***97.482***	***37.831***	***18.349***	***118.146***	***86.943***	***92.750***
Total Investments at 31st March (2)	**74.892**	**85.000**	**141.130**	**148.460**	**37.540**	**57.910**	**41.870**
Investment change	-	*+10.108*	*+56.130*	*+7.330*	*(110.920)*	*+20.370*	*(16.040)*
Net Debt (1 – 2)	**375.271**	**348.855**	**365.721**	**374.185**	**512.852**	**520.143**	**528.746**

* - new borrowing for capital purposes (Waste Recycling Facility and Highways Infrastructure investment). Assumptions include part-funding these schemes through borrowing in advance of need to take advantage of low interest rates before forecast

increases (see Appendix C). The actual timing of borrowing will be kept under review by the Corporate Director Resources.
**- liability based on pre-existing Finance Leases.

3.2.2 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 total debt, net of any investments, 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 2014/15 and the following two financial years (shown as net debt above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

3.2.3 The forecast shown in Table 1 shows the forecast debt for Milton Keynes Council is below its actual and forecast CFR and is therefore only borrowing for capital purposes.

3.3 Treasury Indicators

3.3.1 As mentioned in paragraph 2.1.4, the Prudential and Treasury Indicators are set alongside the overall budget setting process in February as a single comprehensive suite. Once set, those indicators will be applied in the context of all treasury management decisions.

3.4 External Funds

3.4.1 The Council has established three wholly owned limited liability partnerships (LLP);

- Milton Keynes Service Partnership (MKSP) LLP
- MKSP Direct LLP
- Milton Keynes Development Partnership (MKDP) LLP

3.4.2 The purpose, aims and objectives of these LLPs are linked to an annual business plan approved by the Council. The LLPs will follow the Accounting Policies and Principles of the Council, including this Treasury Management Strategy.

3.4.3 Unless otherwise agreed by the LLP Board, counterparty limits will be set proportionately to the limits applied by the Council based on the respective forecast peak cashflow balances.

3.4.4 In accordance with the Local Government Act 2003, the LLPs are deemed as ‘external funds’ and as such any treasury management activities undertaken on behalf of the LLPs will be treated as separate from the Council.

3.4.5 Reports on the treasury management activity undertaken on behalf of the LLPs will be prepared for the LLPs Board in the frequency set out in Section 1.2 of this report.

3.4.6 Should the Council establish any further partnerships of a similar nature, they will be treated in a consistent manner.

3.4.7 **PROSPECTS FOR INTEREST RATES**

3.5 Interest Rate Outlook

3.5.1 Appendix C draws together the forecasts for short term (Bank Rate) and longer fixed interest rates of leading economists UBS and Capital Economics, alongside the view of our Treasury advisors.

3.5.2 Appendix D provides commentary on the UK and global economy throughout the year, as well as the forward view of our Treasury advisors applied to form the forecasts for the future.

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

- Although Eurozone concerns have subsided in 2013, Eurozone sovereign debt difficulties have not gone away and major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international un-competitiveness and the need for overdue reforms of the economy. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

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

- Borrowing interest rates have risen during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, with a significant outline borrowing requirements impending the timing and nature of new borrowing is under careful review;

- There will remain a cost of carry to any new borrowing in the current climate as borrowing costs exceed investment returns achievable in the interim period before the expenditure demand arises.

4 BORROWING STRATEGY

4.1 Context

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

4.2 Approach to borrowing

4.2.1 Against the context (above) and the risks within the economic forecast, caution will be adopted with the 2014/15 treasury operations. The Corporate Director, Resources will monitor or interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

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

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

PWLB Certainty Rates

4.2.2 In November 2012 HM Treasury released details of the PWLB Certainty Rate discount on PWLB loans. This offers a 20 basis point reduction on PWLB loans to eligible authorities – of which Milton Keynes Council is included.

4.2.3 The Interest Rate Forecast included at Appendix C has been adjusted accordingly to reflect this discount.

HRA Self Financing

4.2.4 The 1st April 2012 saw the introduction of the Housing Self-Financing regime. As previously reported this Council adopted a single pool approach, whereby the Council manages its overall debt as a single portfolio and apportions costs to the General Fund and HRA at a consolidated rate in proportion to the debt held by each.

4.2.5 By adopting a single pool approach to apportioning debt charges, any changes to the overall Council debt pool will impact upon the consolidated rate. The Corporate Director Resources will monitor this impact when assessing borrowing options.

4.3 Treasury Management Limits on Activity

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

- **Upper limits on variable interest rate exposure.** This identifies a maximum limit for variable interest rates based upon the debt position net of investments;

- **Upper limits on fixed interest rate exposure.** This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- **Maturity structure of borrowing.** These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

4.3.2 These indicators shall be set in the Prudential and Treasury Indicators report presented alongside the budget setting process.

4.4 Borrowing in Advance of Need

4.4.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

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

4.5 Debt Rescheduling

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

4.5.2 The reasons for any rescheduling to take place will include:

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

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

4.5.4 Details of any rescheduling undertaken will be reported to Cabinet at the earliest meeting following its action.

5 ANNUAL INVESTMENT STRATEGY (AIS)

5.1 Context

5.1.1 The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

5.1.2 The Council's investment priorities will be **security, liquidity**, and **yield – strictly in that order**.

5.1.3 In accordance with the above, and in order to minimise the risk to investments, the Council has set out below the means of accessing acceptable credit quality of counterparties for inclusion on the lending list.

5.1.4 The creditworthiness methodology applied by the Council's treasury advisors is used to compile a counterparty list taking into account the credit ratings and watches published by all three ratings agencies. Ratings are monitored continuously and this information is passed onto the Council.

5.1.5 Further, the Council recognises that ratings should not be the sole determinant of the quality of any institution and that it is important to continually assess and monitor the financial sector, and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the financial markets.

5.1.6 The Council will monitor other information sources including the financial press, share price and other such information relevant to the banking sector, in order to establish a robust scrutiny process to access the suitability of potential investment counterparties.

5.1.7 The aim of this approach is to generate a list of high creditworthy counterparties which will also enable diversification and thus avoid the concentration of risk. In achieving this aim, the Council will seek to protect the security of investments and ensure minimisation of risk.

5.1.8 Investment instruments identified for use in the financial year are listed in Appendix E under the 'Specified' and 'Non-Specified' Investments categories.

5.1.9 Counterparty limits will be set by the Corporate Director Resources and records of limits and usage of counterparties will be maintained by treasury officers in line with the Treasury Management Practice schedules (TMP's).

5.2 Creditworthiness Policy

5.2.1 The Council applies the creditworthiness service provided by its treasury advisors. This service employs modelling techniques utilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors.

5.2.2 The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- "Credit Default Swaps" (CDS) – effectively a form of insurance against default – movements may give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

5.2.3 This modelling approach combines this data into a weighted scoring system which is then compared to the overlay of CDS spreads. The end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties an indicative suggested maximum duration for investments – ranging from three months up to five years.

5.2.4 This methodology does not apply the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The creditworthiness assessment uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue prevalence to just one agency's ratings.

5.2.5 The Council recognises that the responsibility for treasury management decisions remains with the Council at all times. Therefore the Corporate Director Resources is authorised to further restrict or relax the investment names, limits and duration periods in order to safeguard the Council's resources.

5.2.6 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies as soon as possible by its Treasury advisors. If a downgrade results in the counterparty / investment scheme no longer meeting the Council's criteria, its further use as a new investment will be withdrawn immediately.

5.2.7 In addition, extreme movements in market indices may result in counterparty removal from the Council's lending list. However, this data stream is highly sensitive and can be unduly influenced by legitimate market activity. Where sufficient intelligence supports that extreme movements represent a market anomaly, the Corporate Director Resources may reinstate the counterparty to the lending list, if appropriate.

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

5.3 Country, Sector and Group, and Counterparty Limit considerations

5.3.1 The Council takes into consideration the sovereign rating of the country of origin of counterparties that form the approved lending list and where relevant (i.e. a subsidiary), the parent group and its originating country.

5.3.2 Due care will also be taken to considering the banking group and/or sector exposure of the Council’s investments. Limits shall be applied to each counterparty and group/sector, to avoid concentration of funds and the associated risks.

5.3.3 These limits shall be managed and regularly monitored by the Corporate Director Resources, in accordance with paragraph 6.1.9 above.

5.4 Investment Strategy

5.4.1 Investments will be made with reference to the core balance, cash flow requirements and the outlook for interest rates.

5.4.2 Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 2 of 2016 (financial year). Latest Bank Rate forecasts for financial year ends (March) are:

Year	Forecast
2014/15	0.50%
2015/16	0.50%
2016/17	1.25%

5.4.3 There are risks to these forecasts; downside if the start of increases in Bank Rate is delayed, or, upside should it occurs sooner, all depending on economic growth and unemployment levels.

5.4.4 Prudent estimated investment returns for future years have been fed through into the Medium Term Financial Plan (MTFP).

5.4.5 For its cash flow generated balances, the Council will seek to utilise its money market funds, business reserve accounts, short-notice accounts, and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

5.4.6 Core investment funds (those not required to fund immediate cash flow requirements) may be deposited for longer periods, in line with the criteria detailed within this report and relevant indicators.

5.4.7 However, the continued depressed economic climate has led to a market anomaly whereby highly liquid instruments yield a greater return than deposits placed for up to 3-4 months, with the added benefit of affording the Council the ability to react any changes in market conditions. Therefore the Council may also choose to hold core funds in highly liquid instruments as appropriate.

5.5 Local Authority Mortgage Scheme (LAMS)

5.5.1 Like many authorities, the Council is assessing the viability of a Local Authority Mortgage Scheme (LAMS) whereby the Council provides assistance to first-time buyers in entering the housing market.

5.5.2 The Minimum Revenue Provision policy (Appendix B) and Specified and Non-Specified Investments assessment (Appendix E) include appropriate reference to this scheme, should the Council decide to pursue this.

5.6 End of Year Outturn Report

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

5.7 Policy on the use of external service providers

5.7.1 The Council uses Capita Asset Services - Treasury Solutions (formerly Sector) as its external treasury management advisors.

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

5.7.3 The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

5.8 Scheme of Delegation and Role of the Section 151 Officer

5.8.1 Please refer to Appendix F which sets out the responsibilities for treasury management.

APPENDIX A – TREASURY MANAGEMENT POLICY STATEMENT

Treasury Management activity within this Council will be undertaken in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services (The TM Code).

1. This organisation defines its treasury management activities as:

   The management of the organisation's investment 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.

2. This organisation 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 entering into to manage these risks.

3. This organisation acknowledges that effective treasury management will provide support towards the achievements 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 risks management.

In adopting the TM code, this Council shall apply the following four key principles:

1. This organisation will create and maintain, as the cornerstone for effective treasury management:

   i. a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities (this document);
   ii. suitable treasury management practices (TMPs), 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 (this document) and TMPs will follow the recommendations contained in Section 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2. Cabinet will receive reports on its 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 afters its close, in the form prescribed in the TMPs.

APPENDIX A – TREASURY MANAGEMENT POLICY STATEMENT cont.

3. This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury decisions to Corporate Director, Resources who will act in accordance with the organisation's policy statement and TMPs and (if a member) CIPFA's Standard Professional Practice on Treasury Management.

4. This organisation nominates Budget Review Group to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and Policies.

Summary of approach to Borrowing and Investments

Full details of the Council's approach to Borrowing and Investment are contained within the main Treasury Management Strategy report. In summary, these are:

Borrowing; The Council will maintain a cautious approach to borrowing and adopt a pragmatic approach to changes in market circumstances. The Council will also aim to structure borrowing to ensure that the HRA has sufficient capital to meet asset management needs whilst minimising the cost of carrying excessive debt to the HRA. The Council will not borrow in advance purely to profit from the investment of the extra sums borrowed. Loan rescheduling opportunities shall be kept under review.

Investments; The Council's investment priorities will be **security, liquidity,** and **yield – strictly in that order.** Investment activity shall be conducted in accordance the adopted Annual Investment Strategy (AIS). The Council will manage investment balances with reference to core funds, cash flow requirements and the outlook for interest rates.

APPENDIX B – MINIMUM REVENUE PROVISION (MRP) POLICY

The Council is required to pay off an element of the accumulated General Fund borrowing requirement used to 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).

DCLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. Four primary options are set out to council's, however this does not preclude other options so long as there is a prudent provision.

The Council is recommended to approve the following MRP Statement:

Capital Expenditure incurred before 1st April 2008 or future SCE

The major proportion of the MRP charge will relate to the more historic debt liability.

For capital expenditure incurred before 1st April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- Existing practice - MRP will follow the existing practice outlined in DCLG regulations (known as Option 1).

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

Capital Expenditure incurred after 1st April 2008

From 1 April 2008 for all unsupported borrowing except those separately listed in this Policy (including PFI and finance leases) the MRP policy will be either:

- Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (known as Option 3);

- Depreciation method – MRP will follow standard depreciation accounting procedures (known as Option 4);

These options provide for a reduction in the borrowing need over the approximate asset's life.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

APPENDIX B – MINIMUM REVENUE PROVISION (MRP) POLICY cont.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

Housing Revenue Account (HRA)

There is no requirement on the HRA to make a minimum revenue provision. However as a result of HRA reforms the HRA will be required to charge depreciation on its assets, which will have a revenue effect. In order to address any possible adverse impact, transitional regulations allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years.

Repayments included in annual PFI or finance leases are applied as MRP.

Assets for Future Development

For assets acquired for future development, where it is anticipated that the future sale proceeds of the asset will offset the cost, the repayment of the debt may be funded from future capital receipts arising as an alternative prudent provision (thus negating the requirement to provide for MRP).

This approach will be reviewed on an annual basis, to ensure that anticipated capital receipts continue to offset the cost of the debt.

Local Authority Mortgage Scheme (LAMS)

For authorities who participate in the Local Authority Mortgage Scheme (LAMS) using a cash backed option, the mortgage lenders require a 5 year deposit from the local authority to match the 5 year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party.

The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The deposit would be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly.

As this constitutes a temporary (5 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

APPENDIX C – INTEREST RATE FORECAST 2014 – 2017

Capita Asset Services Interest Rate View	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
3 Month LIBID	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.70%	0.90%	1.30%
6 Month LIBID	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%	0.70%	0.80%	1.00%	1.20%	1.40%
12 Month LIBID	0.80%	0.80%	0.80%	0.80%	0.80%	0.80%	1.00%	1.20%	1.40%	1.60%	1.80%	2.00%	2.30%
5yr PWLB Rate	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
10yr PWLB Rate	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
25yr PWLB Rate	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
50yr PWLB Rate	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
UBS	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	2.60%	2.60%	2.60%	2.60%	2.70%	2.80%	3.00%	3.20%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
UBS	3.70%	3.80%	3.90%	4.05%	4.05%	4.30%	4.55%	4.55%	-	-	-	-	-
Capital Economics	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	4.05%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
UBS	4.55%	4.55%	4.80%	4.80%	5.05%	5.05%	5.30%	5.30%	-	-	-	-	-
Capital Economics	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.45%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%
UBS	4.45%	4.45%	4.70%	4.70%	4.90%	4.90%	5.05%	5.05%	-	-	-	-	-
Capital Economics	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.60%	-	-	-	-	-

APPENDIX D – ECONOMIC BACKGROUND

The Global economy

The Eurozone:-

The sovereign debt crisis has eased during 2013 which has been a year of comparative calm after the hiatus of the Cyprus bailout in the spring. The EZ finally escaped from seven quarters of recession in quarter 2 of 2013 but growth is likely to remain weak and so will dampen UK growth. The ECB's pledge to buy unlimited amounts of bonds of countries which ask for a 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 (2012 figures) of 176% Greece, Italy 131%, Portugal 124%, Ireland 123% and Cyprus 110%, remain a cause of concern, especially as many of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are continuing to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US. Greece remains particularly vulnerable and continues to struggle to meet EZ targets for fiscal correction. Many commentators still view a Greek exit from the Euro as inevitable and there are concerns that austerity measures in Cyprus could also end up in forcing an exit. The question remains as to how much damage an exit by one country would do and whether contagion would spread to other countries. However, the longer a Greek exit is delayed, the less are likely to be the repercussions beyond Greece on other countries and on EU banks.

Sentiment in financial markets has improved considerably during 2013 as a result of firm Eurozone commitment to support struggling countries and to keep the Eurozone intact. However, the foundations to this current "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries like Greece and Spain which have unemployment rates of over 26% and unemployment among younger people of over 50%. The Italian political situation is also fraught with difficulties in getting a viable coalition which will implement an EZ imposed austerity programme and undertake overdue reforms to government and the economy.

USA:-

The economy has managed to return to reasonable growth in Q2 2013 of 2.5% y/y in spite of the fiscal cliff induced sharp cuts in federal expenditure that kicked in on 1 March, and increases in taxation. The Federal Reserve has continued to provide huge stimulus to the economy through its $85bn per month asset purchases programme of quantitative easing. However, it is expected that this level of support will start to be tapered down by the end of 2013. It has also pledged not to increase the central rate until unemployment falls to 6.5%; this is probably unlikely to happen until early 2015. Consumer, investor and business confidence levels have improved markedly in 2013.

APPENDIX D – ECONOMIC BACKGROUND cont.

The housing market has turned a corner and house sales and increases in house prices have returned to healthy levels. Many house owners have therefore been helped to escape from negative equity and banks have also largely repaired their damaged balance sheets so that they can resume healthy levels of lending. All this portends well for a reasonable growth rate looking forward.

China:-

Concerns that Chinese growth could be heading downwards have been allayed by recent stronger statistics. There are still concerns around an unbalanced economy which is heavily 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 increasing 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:-

The initial euphoria generated by “Abenomics”, the huge QE operation instituted by the Japanese government to buy Japanese debt, has tempered as the follow through of measures to reform the financial system and introduce other economic reforms, appears to have stalled. However, at long last, Japan has seen strong growth of 4% in the first two quarters of 2013 which portends well for the hopes that Japan can escape from the bog of stagnation and help support world growth. The fiscal challenges though are huge; the gross debt to GDP ratio is about 245% in 2013 while the government is currently running an annual fiscal deficit of around 50% of total government expenditure. Within two years, the central bank will end up purchasing about Y190 trillion (£1,200 billion) of government debt. In addition, the population is ageing due to a low birth rate and will fall from 128m to 100m by 2050.

UK economy

Economic growth:-

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded in quarter 1 (+0.3%) and 2 (+0.7%) of 2013 to surpass all expectations as all three main sectors, services, manufacturing and construction contributed to this strong upturn. The Bank of England has, therefore, upgraded growth forecasts in the August and November quarterly Inflation Reports for 2013 from 1.2% to 1.6% and for 2014 from 1.7% to 2.8%, (2015 unchanged at 2.3%).

Forward surveys are currently very positive in indicating that growth prospects are also strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates.

Forward guidance:-

The Bank of England issued forward guidance in August which stated that the Bank will not start to consider raising interest rates until the jobless rate (Labour Force Survey / ILO i.e. not the claimant count measure) has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years in August, but revised to possibly quarter 4 2014 in November. The UK unemployment rate has already fallen to 7.4% on the three month rate to October 2013 (although the rate in October alone was actually 7.0%). The Bank's guidance is subject to three provisos, mainly around inflation; breaching any of them would sever the link between interest rates and unemployment levels. This actually makes forecasting Bank Rate much more complex given the lack of available reliable forecasts by economists over a three year plus horizon. The recession since 2007 was notable for how unemployment did NOT rise to the levels that would normally be expected in a major recession and the August Inflation Report noted that productivity had sunk to 2005 levels. There has, therefore, been a significant level of retention of labour, which will mean that there is potential for a significant amount of GDP growth to be accommodated without a major reduction in unemployment. However, it has been particularly encouraging that the strong economic growth in 2013 has also been accompanied by a rapid increase in employment and forward hiring indicators are also currently very positive. It is therefore increasingly likely that early in 2014, the MPC will need to amend its forward guidance by reducing its 7.0% threshold rate and/or by adding further wording similar to the Fed's move in December.

Credit conditions:-

While Bank Rate has remained unchanged at 0.5% and quantitative easing has remained unchanged at £375bn in 2013, the Funding for Lending Scheme (FLS) was extended to encourage banks to expand lending to small and medium size enterprises. The second phase of Help to Buy aimed at supporting the purchase of second hand properties, will also start in earnest in January 2014. These measures have been so successful in boosting the supply of credit for mortgages, and so of increasing house purchases, (though levels are still far below the pre-crisis level), that the Bank of England announced at the end of November that the FLS for mortgages would end in February 2014. While there have been concerns that these schemes are creating a bubble in the housing market, house price increases outside of London and the south-east have been much weaker. However, bank lending to small and medium enterprises continues to remain weak and inhibited by banks still repairing their balance sheets and anticipating tightening of regulatory requirements.

APPENDIX D – ECONOMIC BACKGROUND cont.

Inflation:-

Inflation has fallen from a peak of 3.1% in June 2013 to 2.1% in November. It is expected to remain near to the 2% target level over the MPC's two year time horizon.

AAA rating:-

The UK has lost its AAA rating from Fitch and Moody's but that caused little market reaction.

Capita Asset Services forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely during the remainder of 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds.

Near-term, there is some residual risk of further QE - if there is a dip in strong growth or if the MPC takes action to do more QE in order to reverse the rapid increase in market rates, especially in gilt yields and interest rates up to 10 years. This could cause shorter-dated gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below. The failure in the US, (at the time of writing), over passing a Federal budget for the new financial year starting on 1 October, and the expected tension over raising the debt ceiling in mid October, could also see bond yields temporarily dip until any binding agreement is reached between the opposing Republican and Democrat sides. Conversely, the eventual start of tapering by the Fed could cause bond yields to rise.

The longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in economic recovery is also likely to compound this effect as a continuation of recovery will further encourage investors to switch back from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently weighted to the upside after five months of robust good news on the economy. However, only time will tell just how long this period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

Downside risks currently include:

- UK strong economic growth is currently very dependent on consumer spending and recovery in the housing market. This is unlikely to endure much beyond 2014 as most consumers are maxed out on borrowing and wage inflation is less than CPI inflation, so disposable income is being eroded.
- A weak rebalancing of UK growth to exporting and business investment causing a major weakening of overall economic growth beyond 2014.

APPENDIX D – ECONOMIC BACKGROUND cont.

- Weak growth or recession in the UK's main trading partners - the EU and US, depressing economic recovery in the UK.
- Prolonged political disagreement over the raising of the US debt ceiling.
- The Italian political situation is frail and unstable.
- A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.
- A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.
- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- The Italian political situation is frail and unstable; this will cause major difficulties in implementing austerity measures and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.
- Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts, especially if it looks likely that one, or more countries, will need to leave the Eurozone.
- A lack of political will in France, (the second largest economy in the EZ), to dynamically address fundamental issues of low growth, poor international uncompetitiveness and the need for overdue reforms of the economy.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds.

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

- A sharp upturn in investor confidence that sustainable robust world economic growth is firmly expected, causing a surge in the flow of funds out of bonds into equities.
- A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone.
- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
- In the longer term – an earlier than currently expected reversal of QE in the UK; this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.

APPENDIX E – SPECIFIED AND NON-SPECIFIED INVESTMENTS

Specified Investments; Sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes.

Non-Specified Investments; Any other type of investment which does not meet the criteria to be classified as specified.

Assessment; The Council has accessed the classification of investment products as follow:

Specified Investments ***(Maturities up to 1 year)***	**Non Specified Investments** ***(Maturity in excess of 1 year)***
Debt Management Agency Deposit Facility	Term deposits – local authorities
Term deposits – local authorities	Term deposits – banks and building societies
Term deposits – banks & building societies *	Certificates of deposits – banks & building societies
	Fixed term deposits with variable rate and variable maturities:- Structured deposits
	UK Government Gilts
	Commercial Papers/Bonds (Multilateral Banks, or UK Government or Sovereign supported)
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -	
1. Government Liquidity Funds	1. Bond Funds
2. Money Market Funds	2. Gilt Funds
3. Enhanced cash funds	
4. Bond Funds	
5. Gilt Funds	
Local Authority Mortgage Guarantee Scheme; under such scheme the Council would be required to place funds to underwrite risk of default for a period of years. If undertaken this would be classified as a service investment rather than a treasury management investment, and fall outside of the Specified/Non-specified categories.	

*** -** If forward deposits are to be entered into, the forward period plus the deal period should not exceed one year in aggregate to classify as a specified investment. Any forward deposits in excess of one year in aggregate will classify as non-specified.

APPENDIX F – RESPONSIBILITIES FOR TREASURY MANAGEMENT

(i) Council

- approval of annual strategy;
- budget consideration and approval.

(ii) Cabinet

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

(iii) 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;
- delegated authority for operational treasury management decisions as appropriate (as set out in this strategy).