

| REPORT TO | DATE OF MEETING |
|---------------------------------|------------------------------------|
| Governance Committee Cabinet | 30 January 2013 6 February 2013 |

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| SUBJECT | PORTFOLIO | AUTHOR | ITEM |
|--------------------------------------|---------------------|---------------|-------------|
| Treasury Strategy 2013/14 to 2015/16 | Finance & Resources | G Whitehead | 5 |

SUMMARY AND LINK TO CORPORATE PRIORITIES

- To present for the consideration of the Governance Committee and Cabinet the prudential indicators and the treasury strategy for the years to 2015/16.
The report proposes only one change in policy, namely that the three month restriction on deposits with all counterparties other than the part nationalised institutions should end (paragraph 2.11 of the Investment Strategy refers).
It also proposes that the Sector Consultancy contract should be allowed to continue for a further year at the existing price (para. 8 page 7)
Included at Appendix A is the latest Economic Commentary provided by Sector.

RECOMMENDATIONS

- That Governance Committee and Cabinet be asked to recommend that Council approve
 - The Prudential Indicators for 2013/14 to 2015/16, as set out in this report
 - The Treasury Management Strategy for 2013/14, incorporating the Treasury Prudential Indicators
 - The Annual Investment Strategy 2013/14. This proposes the end of the three month limit on investments which has applied since September 2011.
 - The Annual MRP Policy Statement 2013/14
That the contract with Sector Treasury Services be allowed to continue for a further year.

DETAILS AND REASONING

- The Local Government Act 2003, gave authorities greater discretion over capital expenditure by allowing prudential borrowing. It also sought to strengthen governance by making compliance with CIPFA's Prudential Code and CIPFA's Treasury Management Guidance, statutory requirements. The former requires the production of Indicators showing that expenditure is affordable, the latter requires the approval of an annual Treasury Management Strategy incorporating Treasury Indicators and limits.
- Consequential to the Prudential Borrowing powers is a requirement that authorities should make prudential provision for the repayment of borrowing (MRP). This is to be the subject of an annual policy statement to be made to the full Council prior to the start of each year.
- Finally Authorities have, through the Local Government Act 2003, also been given greater discretion in investing surplus cash. They are required however, by guidance issued by the DCLG, to prepare an annual Investment Strategy to identify how that discretion should be applied.
- This report therefore brings together these related requirements. The Governance Committee's role is to scrutinise these policies and practices, while the Council is required to approve them.

PRUDENTIAL INDICATORS 2013/14 to 2015/16

Local Authorities have discretion to incur capital expenditure in excess of the capital resources provided by government, or those resources resulting from the sale of assets or the receipt of contributions from other parties. To do this however increases a Council's indebtedness and ultimately leads to a charge to the revenue budget.

To manage that process Councils must set certain Indicators. These are designed to indicate that the expenditure is prudent and affordable. The following are the relevant indicators for South Ribble.

Prudential Indicator 1 - Capital Expenditure

The following statement summarises the latest estimates of capital expenditure and the methods of financing the programme. It shows separately the cost of capital works at Leisure Centres, undertaken by Serco on behalf of South Ribble Community Leisure Trust. Since the assets are owned by the Council this has to be accounted for as a form of finance lease.

The unfinanced expenditure relates to new, replacement, vehicle acquisitions

| Table 1 – Capital Expenditure | 2012/13 Estimate £'000 | 2013/14 Estimate £'000 | 2014/15 Estimate £'000 | 2015/16 Estimate £'000 |
|--|------------------------------|------------------------------|------------------------------|------------------------------|
| Capital expenditure under Leisure Contract – treated as a finance lease (affects the CFR see Prudential Indicator 2 below) | 831 | 0 | 100 | 437 |
| Capital expenditure incurred directly by the Council | 3,720 | 2,942 | 2,430 | 2,068 |
| Less Capital resources | | | | |
| capital receipts | (696) | (107) | (370) | 0 |
| Grants & contributions | (812) | (690) | (233) | (233) |
| Revenue and reserves | (1,177) | (1,695) | (1,394) | (812) |
| Unfinanced amount (affects the CFR see Prudential Indicator 2 below) | 1,035 | 450 | 433 | 1,023 |

Prudential Indicator 2 – Capital Financing Requirement (CFR)

The CFR is a measure of the Council's indebtedness resulting from its capital programme. It increases when, as above, the Council incurs unfinanced capital expenditure or leases liabilities. Its importance lies in the fact that it results in a charge to the revenue account, either from the lessor to discharge his debt, or an internal charge to make provision to finance the expenditure (the Minimum Revenue Provision).

It should be noted that this indebtedness does not result in the Council having an immediate need to take out additional borrowings. This is because the Council has various reserves, and the cash which supports those reserves can be used temporarily instead of borrowing.

The CFR is important therefore because it creates a charge which hits the council tax payer. The following table shows how the CFR is changing over the next few years.

| Table 2 - CFR | 31/03/13 Revised £'000 | 31/03/14 Estimate £'000 | 31/03/15 Estimate £'000 | 31/03/16 Estimate £'000 |
|---|------------------------------|-------------------------------|-------------------------------|-------------------------------|
| Estimated CFR | 6,635 | 6,228 | 5,839 | 6,324 |
| Reasons for the annual change in the CFR | | | | |
| Additional finance lease liability | | 0 | 100 | 437 |
| Unfinanced capital expenditure (as above) | | 450 | 433 | 1,023 |
| Repayment of finance lease | | (246) | (259) | (259) |
| Annual revenue charge (MRP) | | (611) | (663) | (716) |

Prudential Indicator 3 – Ratio of financing costs to the net revenue stream

This indicator shows the proportion of the Council's budget (i.e. the costs it has to meet from government grants and local taxpayers), that is required to meet the costs associated with capital financing (interest and principal, net of interest received). This is increasing for two reasons. Firstly the MRP charges, based on the lives of the new vehicles, exceeds that on the vehicles replaced, and secondly the "net revenue stream" is reducing as a result of the reductions in government funding.

| Table 3 – Ratio of financing costs | 2012/13 Estimate % | 2013/14 Estimate % | 2014/15 Estimate % | 2015/16 Estimate % |
|------------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Ratio | 4.13 | 5.51 | 6.33 | 7.02 |

Prudential Indicator 4 – Incremental impact of capital investment decisions on the band D Council Tax

| Table 4 – Impact of capital investment decisions | 2012/13 Estimate £ | 2013/14 Estimate £ | 2014/15 Estimate £ | 2015/16 Estimate £ |
|--|--------------------------|--------------------------|--------------------------|--------------------------|
| Increase/(decrease) in Band D charge | (1.64) | (2.56) | 0.30 | 4.68 |

This table shows the cumulative effect on council tax levels of the changes between the capital programme reported in this strategy and that submitted a year ago. It has to be stressed that the complexity, and notional nature, of the calculations mean that the figures should only be treated as being indicative.

The reduction in costs for the years to 2013/14 is consistent with a slight reduction in total capital spend over the years 2011/12 to 2013/14. The increase in 2015/16 reflects the introduction of a new year into the programme. In addition changes in the methods of financing the programme over the years have contributed to the movements in the figures.

TREASURY MANAGEMENT STRATEGY 2013/14

1. Background

The treasury management service fulfils an important role in the overall financial management of the Council's affairs. It deals with "*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*" (CIPFA).

Prudential Indicators 5 and 6

The Council has a statutory obligation to have regard to the CIPFA Code of Practice (revised in 2009 and updated further in 2011), and is required to adopt both the Code and the Treasury Management Policy Statement therein. Both of these were adopted by Council on 3 March 2010 (Financial Regulation 4G refers). The Policy Statement is repeated at Appendix B

2. Reporting

This strategy statement has been prepared in accordance with the revised Code. As a minimum, a mid year monitoring report and a final report on actual activity after the year end, will be submitted to the Council. Additional reports will be made to the Governance Committee during the year as required.

3. Borrowing and Investment Projections

The Council's borrowings and investment are inter-related. The following table details the expected changes in borrowings and cash, consistent with the capital and revenue budgets. It will be seen that cash balances are expected to remain at an adequate level and no borrowing is envisaged in the period under review.

| Table 5 – Borrowing and Investments | 31 Mar 2013 Estimate £'000 | 31 Mar 2014 Estimate £'000 | 31 Mar 2015 Estimate £'000 | 31 Mar 2016 Estimate £'000 |
|--|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Borrowing | 0 | 0 | 0 | 0 |
| Est. surplus cash available for investment | 10,314 | 8,534 | 7,565 | 7,391 |
| Net borrowing | 10,314 | 8,534 | 7,565 | 7,391 |

Prudential Indicator 7

The Prudential Code requires authorities to make comparison between net borrowing and the CFR. At its greatest net borrowing should not exceed the current year's CFR plus the estimated increases in CFR for the following two years. The figures reported above meet this requirement.

Prudential Indicator 8 The Operational Boundary for External Debt

The Council is required to set two limits on its external debt (i.e. the amounts it owes to lessors and any amounts it borrows directly). The first is the Operational Boundary. This should reflect the most likely, but not worst case scenario consistent with the Council's budget proposals.

As shown in table 5 above, it is not expected that additional borrowings will be required in the years covered by this strategy. The proposed operational boundary therefore reflects the expected leasing liabilities.

| Table 6 – Operational Boundary | 31/3/13 Estimate £'000 | 31/3/14 Estimate £'000 | 31/3/15 Estimate £'000 | 31/3/16 Estimate £'000 |
|--------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Borrowings | 0 | 0 | 0 | 0 |
| Other long term liabilities | 1,800 | 1,600 | 1,400 | 1,600 |
| Operational boundary | 1,800 | 1,600 | 1,400 | 1,600 |

Prudential Indicator 9 The Authorised Limit

This is the second limit. It should allow headroom above the Operational Boundary to accommodate the fluctuations that can occur in cash flows. The following is proposed:

| Table 7 Authorised Limit | 31/3/13 Estimate £'000 | 31/3/14 Estimate £'000 | 31/3/15 Estimate £'000 | 31/3/16 Estimate £'000 |
|-----------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Borrowings | 2,000 | 2,000 | 2,000 | 2,000 |
| Other long term liabilities | 1,800 | 1,600 | 1,400 | 1,600 |
| Authorised limit | 3,800 | 3,600 | 3,400 | 3,600 |

4. Economic outlook and expected movement in interest rates

The report of the Council's consultants is attached at Appendix A.

Not surprisingly they stress the huge economic uncertainties, and conclude that the overall balance of risk is still to the downside. An increase in base rate is no longer envisaged in the period covered by the strategy. They also refer to the possibility of the UK Sovereign rating being reduced from AAA. There has not been a significant reaction to the downgrade of other sovereign ratings, but there is the potential for it to adversely affect Government borrowing costs, which could have consequence to local authorities borrowing costs.

5. Borrowing strategy

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. This is possible because cash, supporting the Council's reserves, balances and cash flow, has been used as a temporary measure. This strategy is prudent as investment returns are low and the range of counterparties is narrow.

Table 5 above shows that cash balances should remain throughout the period. On this basis no further long term borrowing should be necessary, although there is the possibility of short term borrowings being necessary to cover fluctuations in cash flow.

6. Icelandic Investment

Heritable Repayments made have increased to 77.21% of the claim.. The Administrators base case assumes a recovery of 86% to 90%

Landsbanki Repayments made amount to 49.6%.

A district court will hear argument in the summer concerning which rates of exchange to use when converting repayments in various currencies into sterling. Thus far the Winding Up Board has applied the rates at the date of claim (22/4/09) and ignored the impact of changes since then. This may go to appeal to the Supreme Court which would delay resolution until the autumn. No further repayments will be made until this issue is finally resolved.

Recovery of 100% of the claim is expected, subject to any exchange rate loss.

7. Treasury Management Limits on Activity

The Authority is required to set the following Treasury Indicators. The purpose of these is to minimise the risk resulting from movements in interest rates.

Treasury Indicator 1 – Upper limit on Variable rate exposure

The Council is exposed to interest rate movements on its invested cash. The amount varies significantly over the course of the year, and during each month. Potentially balances can peak at around £25m for short periods. This amount will therefore form the limit

| | 2012/13 Revised | 2013/14 Estimate | 2014/15 Estimate | 2015/16 Estimate |
|---|--------------------|---------------------|---------------------|---------------------|
| Upper limit on variable rate exposure - | £25m | £25m | £25m | £25m |

Treasury Indicator 2 – Upper limit on fixed rate exposure

The Council is exposed to fixed rate interest on the finance lease liabilities. The maximum estimated exposure is based on the Operational Boundary (PI 9 above).

| | 2012/13 Revised | 2013/14 Estimate | 2014/15 Estimate | 2015/16 Estimate |
|------------------------------------|--------------------|---------------------|---------------------|---------------------|
| Upper limit on fixed rate exposure | £1.8m | £1.6m | £1.4m | £1.6m |

Treasury Indicator 3 - Maturity structure of borrowing

The Council is required to determine upper and lower limits for the maturity structure of its borrowings. The Council will have no borrowings at 31/3/13 and none are envisaged over the period covered by this strategy. Therefore the upper and lower limits are.

| | As at 31/3/2013 | |
|----------------------|-----------------|----------------|
| | Lower Limit | Upper Limit |
| Under 12 months | 0% | 0% |
| 12 months to 2 years | 0% | 0% |
| 2 to 5 years | 0% | 0% |
| 5 to 10 years | 0% | 0% |
| 10 years and above | 0% | 0% |

Treasury Indicator 4 – Total principal sums invested for greater than 364 days

It is not planned to make any investments for periods over 364 days.

8. Use of Treasury Advisors

The Council's contract with Sector Treasury Services runs to March 2013. It is proposed to allow the contract to run on for a further period of one year, to 31 March 2014, at the same price.

The Council recognises that responsibility for treasury decisions cannot be delegated to the advisor but remain its responsibility at all times.

9. Performance Indicators

Investments – the generally accepted indicator is 7-day LIBID (The London Interbank Bid rate). This is the rate that could be obtained by the "passive" deposit of money onto the money market. Active investment, in normal times, should outperform this. It is recommended that this be set as an indicator.

INVESTMENT STRATEGY 2013/14

1. Introduction

- 1.1 Under the Power in Section (15) (1) of the Local Government Act 2003 the CLG has issued Guidance on Local Government Investments. This was updated with effect from 1 April 2010. Each Authority is recommended to produce an annual strategy that sets out its policies to manage investments, giving priority to security and liquidity. This strategy follows the guidance.
- 1.2 The major element in the guidance is that authorities should distinguish between lower risk (specified investments), and other investments (non-specified). These terms are explained in more detail below.
- 1.3 The specific issues to be addressed in the Investment Strategy are as follows:
- How “high” credit quality is to be determined
 - How credit ratings are to be monitored
 - To what extent risk assessment is based upon credit ratings and what other sources of information on credit risk are used
 - The procedures for determining which non specified investments might prudently be used
 - Which categories of non-specified investments the Council may use
 - The upper limits for the amounts which may be held in each category of non-specified investment and the overall total.
 - The procedures to determine the maximum periods for which funds may be committed.
 - What process is adopted for reviewing and addressing the needs of members and treasury management staff for training in investment management.
 - The Authority’s policies on investing money borrowed in advance of spending needs. The statement should identify measures to minimise such investments including limits on (a) amounts borrowed and (b) periods between borrowing and expenditure

2. South Ribble Strategy 2013/14

Objectives

2.1 The Council’s investment priorities are:

- The security of capital and
- The liquidity of its investments.

2.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

2.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. The Council will restrict borrowing in excess of its immediate need, to that envisaged to be required in the following eighteen months.

Use of Specified and Non-Specified Investments

2.4 Specified investments are those made:

- with high “quality” institutions, the UK Government or a local authority,
- for periods of less than one year and
- denominated in sterling.

Other investments are “non-specified”. These could include investments in gilts, bond issues by other sovereign bodies and those issued by multilateral development banks, commercial paper, and any deposits for a period exceeding one year.

The Council policy has been to only make specified investments, and it is proposed that this be continued.

Counterparty Selection Criteria

2.5 In determining which institutions are “High Quality” the Council uses the creditworthiness service provided by Sector. This combines the credit ratings from all three rating agencies (Fitch, Moody, Standard and Poor) in a sophisticated modelling process. It does not however rely solely on these ratings, but also uses

- Credit watches and credit outlooks from the agencies
- Credit Default Spreads (CDS) to give early warning of likely changes in ratings
- Sovereign ratings to select counterparties from only the most credit worthy countries

These factors are combined in a scoring system, and results in counterparties being colour coded:

- Purple – recommended maximum duration 2 years
- Blue (used for nationalised and part nationalised UK Banks)– 1 year
- Orange – 1 year
- Red – 6 months
- Green – 3 months
- No colour – not to be used

2.6 The Council has also chosen to restrict lending to UK financial institutions. Currently no such institutions attract a purple colour code.

2.7 The Council may use AAA rated Money Market Funds.

2.8 The Council may lend to the UK Government (which includes the Debt Management Office)

2.9 The Council may lend to other Local Authorities.

2.10 Previous Treasury Strategies have specified a minimum sovereign rating of AAA from all three agencies. Downgrades to the USA and France, and the threat that other countries including the UK could at some future date also be downgraded, necessitated a reduction to a AA- minimum sovereign rating (approved in 2012/13 Treasury Strategy).

2.11 In September 2011, at Sector’s recommendation, the Council chose to restrict all investments with financial institutions other than those which were part nationalised, to a maximum duration of three months. **Sector have now recommended that this restriction should be removed.** It is not anticipated this will have a significant effect, since the stand alone ratings of institutions with whom the Council deals do not warrant investment for longer periods.

Monitoring of Credit ratings

2.12 Sector supply rating warnings and changes immediately following their issuance by the rating agencies. The colour coded counterparty lists are reissued weekly, updated by such changes.

Time and money Limits

2.13 No changes to the present limits are proposed. The limits applying to each category of institution are specified in the attachment to this report

Member Training

2.14 There are no plans to provide additional training in 2013/14.

Change of Bank

2.15 Barclays Bank will become the banker to the Council w.e.f. April 2013. The bank currently meets the Council’s credit criteria for deposits up to three months. The bank offers a deposit account facility that will be useful at times when cash balances are at a maximum.

Interest earnings in 2013/14 - Impact of the Funding for Lending scheme

2.16 The Council has benefitted over the last couple of years from the "special tranche" rates offered on deposits with the part nationalised banks. As recently as October 2012 the RBS Group offered 1.50% for twelve months money and the Lloyds Group 2.70%. The introduction, by the Government, of the Funding for Lending Scheme, enabling Banks to access cheap funds to stimulate lending, has seen the collapse of these rates. As of 14 January they are totally withdrawn.

Financial Institutions and Investment Criteria, incorporating changes proposed in 2013/14 Treasury Strategy

| Category | Institutions | Sector colour code | Sovereign rating | Max period | Limit per Institution |
|--|---|--------------------|--------------------------------|-----------------------------------|---------------------------------|
| Sovereign or Sovereign "type" | DMADF | | | 6 months | No limit |
| | Local Authority | | | 1 year | £3m |
| | UK Govt backed Money market funds | | | n/a instant access | £3m |
| UK Nationalised Institutions | None (N Rock deposits no longer guaranteed) | | | | |
| Institutions guaranteed by other governments | None (Irish Banks are guaranteed but have been removed from the list) | | | | |
| UK Partly nationalised institutions | RBS group (inc Nat West) | Blue | AAA stable from all 3 agencies | 1 year | £3m per group |
| | Lloyds Group (inc HBoS & Lloyds) | Blue | | 1 year | £3m per group |
| Independent UK Institutions | HSBC | Orange | AAA stable from all 3 agencies | 1 yr | £2m |
| | Barclays, | Green | | 3 months | £2m |
| | Nationwide | Green | | 3 months | |
| Money Market Funds | Prime Rate Sterling Liquidity Fund 4 | Aaa/MR1+ | | instant access | £3m |
| | Ignis | | | | |
| | Blackrock | | | | |
| Deposit/Call Accounts | Bank of Scotland, | | | Call accounts with instant access | £3m less value of term deposits |
| | Nat West | | | | |
| | Lancs CC | | | | |

Note – Deposits with any one institution shall not exceed £3m

Note – minimum Sovereign Rating is AA

Note – Santander is currently excluded from this list because of market perception as shown by the credit default spread.

ANNUAL STATEMENT OF MRP POLICY 2013/14

Regulations specify the minimum provision that a Council must make for the repayment of its debt. This is referred to as the MRP.

The Council will assess their MRP for 2013/14 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The major proportion of the MRP for 2013/14 relates to debt incurred prior to 2008/9. MRP will continue to be charged on this at the rate of 4%, in accordance with option 1 of the guidance. There are some capital schemes since then which generate a further MRP liability (i.e. capital expenditure which is not financed by any grant or contribution e.g. vehicles). The MRP liability on this will be based on the estimated useful life of the asset, using the equal annual instalment method of calculation (option 3 of the guidance).

Estimated life periods will be determined under delegated powers with reference to the guidance. As some types of capital expenditure are not capable of being related to an individual asset, the MRP will be assessed on a basis which most reasonably reflects the anticipated period of benefit arising from the expenditure.

WIDER IMPLICATIONS

In the preparation of this report, consideration has been given to the impact of its proposals in all the areas listed below, and the table shows any implications in respect of each of these. The risk assessment which has been carried out forms part of the background papers to the report.

| | | | |
|---|---|---|---|
| FINANCIAL | The financial implications are covered in the report | | |
| LEGAL | The strategy ensures compliance with various regulations and statutory codes of practice | | |
| RISK | The Council's treasury management strategy and policies are designed to ensure the effective control and management of the risks associated with such activities. | | |
| OTHER (see below) | | | |
| <i>Asset Management</i> | <i>Corporate Plans and Policies</i> | <i>Crime and Disorder</i> | <i>Efficiency Savings/Value for Money</i> |
| <i>Equality, Diversity and Community Cohesion</i> | <i>Freedom of Information/ Data Protection</i> | <i>Health and Safety</i> | <i>Health Inequalities</i> |
| <i>Human Rights Act 1998</i> | <i>Implementing Electronic Government</i> | <i>Staffing, Training and Development</i> | <i>Sustainability</i> |

BACKGROUND DOCUMENTS

Financial Strategy/Budget and Council Tax 2013/14
 Treasury Management in the Public Services: Code of Practice
 CIPFA Prudential Code for Capital Finance in Local Authorities

APPENDIX A

The following is the advice of the Council's consultants – Sector (December 2012)

“Economic outlook and expected movement in interest rates

The interest rate forecast is as follows:

| | Mar-13 | June-13 | Sep-13 | Dec-13 | Mar-14 | June-14 | Sep-14 | Dec-14 | Mar-15 |
|-----------|--------|---------|--------|--------|--------|---------|--------|--------|--------|
| Bank rate | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% |
| 5yr PWLB | 1.50% | 1.50% | 1.60% | 1.60% | 1.70% | 1.70% | 1.80% | 2.00% | 2.20% |
| 10yr PWLB | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% | 2.70% | 2.80% | 3.00% | 3.20% |
| 25yr PWLB | 3.80% | 3.80% | 3.80% | 3.80% | 3.90% | 3.90% | 4.00% | 4.10% | 4.30% |
| 50yr PWLB | 4.00% | 4.00% | 4.00% | 4.00% | 4.10% | 4.10% | 4.20% | 4.30% | 4.50% |

In summary, our views on the prospects for GDP growth in the major global economies are as follows: --

UK

- The Bank of England November 2012 Inflation Report has again pushed back the timing of a return to trend growth and the rate at which inflation will fall back towards the target rate of 2%.
- It now looks likely that Q4 2012 will see a return to negative growth. If this negativity continues into the first quarter of 2013 it would be the first triple dip recession since records began in 1955.
- A fair proportion of UK GDP is dependent on overseas trade; the high correlation of UK growth to US and Eurozone GDP growth means that the UK economy is likely to register weak growth over 2013 and 2014.
- Consumers are likely to remain focused on paying down debt. Weak consumer sentiment and job fears will all act to keep consumer expenditure suppressed; this will be compounded by inflation being higher than increases in average earnings i.e. disposable income will still be eroded.
- The Coalition government is hampered in promoting growth by the need to tackle the budget deficit.
- Little sign of a coordinated strategy for the private sector to finance a major expansion of infrastructure investment to boost UK growth.
- There is potential for more QE in 2013 which will help to keep gilt yields lower than they would be otherwise.
- On the other hand, recent discussion around reformulating how RPI is calculated could adversely affect demand for inflation indexed gilts in particular, but also gilts generally, if this proposal is taken forward and was perceived to be a softening of the stand against inflation in the UK.
- The main rating agencies have all made it clear they are reviewing the UK's "AAA" status in early 2013. There is a material chance of the current ratings being downgraded. Although the UK will retain its "safe haven" status, a change in rating may place some upside pressure on gilt yields.

US

- GDP growth is likely to remain weak at around 2% - but that is a lot better than the prospects for the UK and Eurozone.
- The Fed has indicated that is unlikely to increase the central rate until 2015. It changed its policy targets to focus specifically on the employment sector. The new target is for unemployment to fall to 6.5% before official policy rates are raised.
- The "fiscal cliff" has only been partially dealt with at the beginning of January 2013. Increasing the debt ceiling and agreeing the cuts in expenditure part of the "fiscal cliff" will need to be resolved within the next two months.
- The housing market is showing some sustainable signs of having turned a corner.

Eurozone

- Austerity programmes in the various “peripheral” countries are starting to show signs of having an effect in reducing growth rates in “core” countries. The Eurozone looks as if it is heading for another quarter of negative growth in Q4 2012 and prolong the recession which began in Q3.

China

- Efforts to stimulate the economy appear to be succeeding towards the end of 2012. However, there are still concerns around the unbalanced nature of the economy which is heavily dependent on new investment expenditure. The potential for the bubble in the property sector to burst, as it did in Japan in the 1990s, could have a material impact on the economy as a whole.

Sector's forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely during 2013 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds. Equity prices staged a significant rise during the second half of 2012 and the start of January, accompanied by a fall in bond prices and a rise in bond yields. 2013 is likely to see a tug of war between bond and equity prices as ebbs and flows in investor confidence and fears cause recurring spikes and falls in their prices.

The overall balance of risks to economic recovery in the UK remains weighted to the downside. 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. Although the prospect of further QE is likely to keep gilt yields lower than they would otherwise be in the near term, this programme is not everlasting. At some stage, the expectation of a conclusion to QE will add to the upside pressure on gilt yields”

APPENDIX B

Treasury Management Policy Statement (adopted 2nd March 2010)

1. This organisation defines its treasury management activities as: *The management of the 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.*
2. This organisations regards the succesful 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 managementa ctivities will focus on their risk implications for the organisation.
3. This organisation 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 management techniques, within the context of effective risk management.