APPENDIX A

Borough of Pendle

PENDLE BOROUGH COUNCIL

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

2013/14

1 INTRODUCTION

1.1 Background

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

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

CIPFA defines treasury management as:

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

1.2 Reporting requirements

The Council is required to receive and approve the overall policy and strategy within which treasury management activity takes place. Within this framework the apporach followed at Pendle is one in which update reports are presented to the Executive on a periodic basis together with a report setting out the actual year end position. An overview of the process is provided below:

Prudential and treasury indicators and treasury strategy (this report - Council) - The first, and most important report covers:

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

A mid year treasury management report (Executive) – 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.

An annual treasury report (Executive) – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny (In year monitoring)
This role is undertaken by the Accounts and Audit Committee who receive regular updates on treasury management activity during the year.

1.3 Treasury Management Strategy for 2013/14

The strategy for 2013/14 covers two main areas:

Capital issues

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

Treasury management issues

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

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. Periodic updates are provided to Members, primarily on the Accounts and Audit Committee. The training needs of treasury management officers are periodically reviewed as part of the annual appraisal process..

1.5 Treasury management consultants

The Council uses Sector as its external treasury management advisors.

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

2 THE CAPITAL PRUDENTIAL INDICATORS 2013/14 – 2015/16

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 Councillor's overview and confirm capital expenditure plans.

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The capital expenditure forecasts shown below were approved by Council on 21st February 2013:

Capital expenditure £'000	2011/12 Actual	2012/13 Projected	2013/14 Estimate[1]	2014/15 Estimate[2]	2015/16 Estimate[2]
Private Sector Housing	7,388	3,638	7,947	500	500
Car Parks, Flooding etc	412	120	203		
Other Miscellaneous projects	117	579	583	115	105
Community Safety	35	169	0	0	0
Asset Renewal (excluding Parks)	349	905	806	200	200
Parks and Recreational Services	540	1,961	326	0	0
Resource Procurement	1,330	750	282	0	0
Area Committees	411	450	461	200	200
Total	**10,582**	**8,572**	**10,608**	**1,015**	**1,005**

Other long term liabilities. The above financing need excludes other long term liabilities, such as leasing arrangements which already include borrowing instruments.

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need

Capital expenditure £m	2011/12 Actual	2012/13 Projected	2013/14 Estimate	2014/15 Estimate[2]	2015/16 Estimate[2]
Total	10,582	8,572	10,608	1,015	1,005
Financed by:					
Capital receipts	1,826	1,191	1,562	100	100
Capital grants/contributions	5,742	1,391	1,870	350	350
Revenue/Leasing	1,214	353	100	100	100
Net financing need for the year	**1,800**	**5,637**	**7,076**	**465**	**455**

[1] Includes slippage brought forward from 2012/13 estimated at £6.245m
[2] Indicative only at this stage subject to further work in subsequent budget rounds

2.2 The Council's borrowing need (the Capital Financing Requirement)

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

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £0.4m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Capital Financing Requirement					
CFR	10,192	15,282	21,761	21,499	21,177
Total CFR	**10,192**	**15,282**	**21,761**	**21,499**	**21,177**
Movement in CFR		**5,090**	**6,479**	**(262)**	**(322)**

Movement in CFR represented by					
Net financing need for the year (above)		5,637	7,076	465	455
Less in year MRP and other financing movements		(547)	(597)	(727)	(777)
Movement in CFR		**5,090**	**6,479**	**(262)**	**(322)**

2.3 Minimum revenue provision (MRP) policy statement

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

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

For capital expenditure incurred before 1 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 former CLG regulations (option 1). This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including finance leases) the MRP policy will be*:*

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (option 3 per CLG using the annuity method under which annual payments gradually increase during the life of the asset);

In the event that the Council participates in the Local Authority Mortgage Scheme using the cash backed option, the mortgage lender(s) will require a five year deposit from the Council to match the five 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 is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the Council, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. Whilst this does not apply currently as the Council participates in the scheme using the non-cash backed option it is included in this policy in the event that the Council's participation changes.

The Council also plans to borrow to finance specific housing projects, namely the Presbytery scheme in Whitefield, Nelson and properties under the Improvement for Sale scheme. The intention is to repay this borrowing from the capital receipts generated by the sale of the properties over a period of 5 years. In a similar fashion to the LAMS scenario outlined above, the capital expenditure incurred under these projects will increase the CFR. However, as it is intended to repay this borrowing from receipts over a 5 year term there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

Repayments included in finance leases are applied as MRP.

2.4 Affordability prudential indicators

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

2.5 Ratio of financing costs to net revenue stream.

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

%	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
General Fund	3.13%	4.98%	7.05%	9.95%	11.12%

The estimates of financing costs include current commitments and the proposals agreed by Council when approving the capital programme in February 2013.

2.6 Incremental impact of capital investment decisions on council tax.

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Incremental impact of capital investment decisions on the band D council tax

£	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Council tax - band D	10.34	27.07	28.95

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the 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 approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2012, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	2011/12 Actual	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
External Debt					
Debt at 1 April	7,956	6,956	8,956	11,956	12,456
Expected change in Debt	(1,000)	2,000	3,000	500	500
Other long-term liabilities (OLTL)	171	165	158	153	147
Expected change in OLTL	(6)	(7)	(6)	(6)	(6)
Actual gross debt at 31 March	**7,121**	**9,114**	**12,108**	**12,603**	**13,097**
The Capital Financing Requirement	**10,192**	**15,282**	**21,736**	**21,474**	**21,152**
Under / (over) borrowing	**3,071**	**6,168**	**9,628**	**8,871**	**8,055**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Head of Central Services reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the Budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £'000	2012/13 Estimate (revised)	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	11,000	13,000	13,500	14,000
Other long term liabilities	2,000	2,000	2,000	2,000
Total	13,000	15,000	15,500	16,000

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

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Authorised limit £'000	2012/13 Estimate (revised)	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Debt	12,000	15,000	15,500	16,000
Other long term liabilities	2,500	2,500	2,500	2,500
Total	14,500	17,500	18,000	18,500

3.3 Prospects for interest rates

The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
March 2013	0.50	1.80	4.10	4.20
June 2013	0.50	1.80	4.10	4.20
Sept 2013	0.50	1.80	4.10	4.20
Dec 2013	0.50	1.80	4.10	4.20
March 2014	0.50	1.90	4.20	4.40
June 2014	0.50	2.00	4.20	4.40
Sept 2014	0.50	2.10	4.30	4.50
Dec 2014	0.50	2.20	4.40	4.60
March 2015	0.75	2.40	4.60	4.70
June 2015	1.00	2.50	4.60	4.80
Sept 2015	1.25	2.60	4.80	4.90
Dec 2015	1.50	2.80	4.90	5.00
March 2016	1.75	3.00	5.00	5.10

The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the economy returned to positive growth in the third quarter of 2012. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income, general malaise about the economy and employment fears.

The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Euozone so the difficulties in this area are likely to continue to hinder UK growth. The US, the main world economy, faces similar debt problems to the UK, but urgently needs to resolve the fiscal cliff now that the the Presidential elections are out of the way. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth and is likely to see the UK deficit reduction plans slip.

This challenging and uncertain economic outlook has several key treasury mangement implications:

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2013/14 and beyond;
- Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

3.4 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 as 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 counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2013/14 treasury operations. The Head of Central Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was 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 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.

- *if it was 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 funding will be drawn whilst interest rates were still relatively cheap.

Any decisions will be reported to Councillors at the next available opportunity.

The revenue budget approved for the current financial year assumes net new borrowing of £2m. The capital programme for 2013/14 assumes net new borrowing of £3m the majority of which is linked to medium term projects (e.g. Presbytery). The debt charges associated with this borrowing (interest charges and MRP where applicable) will be met by the General Fund revenue budget. The borrowing costs of £1m used to fund works to Improvement for Sale properties are being met from an early tranche of the New Homes Bonus as previously agreed by Councillors.

The timing of any further borrowing will be determined by reference to market conditions and considerations as outlined above drawing on advice from Sector.

Treasury management limits on activity

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- 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. The Council is asked to approve the following treasury indicators and limits:

£m	2013/14	2014/15	2015/16
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%
Limits on fixed interest rates based on debt only	100%	100%	100%
Limits on variable interest rates based on debt only	25%	25%	25%
Limits on fixed interest rates based on investments only	100%	100%	100%
Limits on variable interest rates based on investments only	25%	25%	25%
Maturity structure of fixed interest rate borrowing 2013/14			
		Lower	**Upper**
Under 12 months		0%	25%
12 months to 2 years		0%	40%
2 years to 5 years		0%	60%
5 years to 10 years		0%	75%
10 years and above		0%	100%

Maturity structure of variable interest rate borrowing 2013/14		
	Lower	**Upper**
Under 12 months	0%	25%
12 months to 2 years	0%	25%
2 years to 5 years	0%	25%
5 years to 10 years	0%	0%
10 years and above	0%	0%

3.5 Policy on borrowing in advance of need

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.

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

3.6 Debt rescheduling

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

The reasons for any rescheduling to take place will include:

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

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

All rescheduling will be reported to the Executive, at the earliest meeting following its action

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second and then return.

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology adopted has regard to the rating service provided by our advisers, Sector, particularly with regard to the maximum duration for investment. Under Sector's ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Furthermore, it is acknowledged that ratings are not the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis 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 markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Sector in producing its colour codings which show the varying degrees of suggested creditworthiness.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

Investment instruments identified for use in the financial year are listed in appendix 5.3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 Creditworthiness policy

The Council has developed a lending list which presently restricts investments to the following counterparties:

- Designated UK banks meeting specified financial ratings as defined by Fitch
- UK Building Societies (Nationwide B/Society only)
- Principal Local Authorities
- UK Government (Debt Management Office / Treasury Bills)
- Money Market Funds (CCLA Public Sector Deposit Fund only)

Each counterparty has a limit applied both in terms of the maximum that may be invested and for the duration of investment. In developing and maintaining this lending list the Council has regard to the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Blue 364 days (only applies to nationalised or part nationalised UK Banks)
- Orange 364 days
- Red 6 months
- Green 3 months
- No colour not to be used

The Sector creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch) of F1, long term rating A-, viability rating of BB+, and a support rating of 1.

All credit ratings will be monitored weekly following receipt of the updated weekly listing from Sector. The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

The Local Authority Mortgage Scheme (LAMS) – The Council is currently particpating in this scheme using the unfunded indemnity option as reported previously to the Executive. The Council may opt to participate in this scheme using the cash backed indemnity option which requires the Council to place a matching five year deposit to the life of the indemnity. In this scenario this investment is an integral part of the policy initiative and is outside the criteria above.

4.3 Country limits

It is proposed that the Council will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ (per Fitch ratings). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy. Councillor's will be aware that the UK sovereign rating was recently downgraded from AAA by Moodys. At the time of writing this Strategy the rating provided by the other agencies (Fitch and S&P) remained AAA. Regardless of the change in the UK sovereign rating, the Council will continue to invest in UK banks provided the institution meets the minimum lending criteria set out in section 4.2 above.

4.4 Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 1 of 2015. Bank Rate forecasts for financial year ends (March) are:

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

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even 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.

Sector suggest that budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next three years are as follows:

2013/14	0.50%
2014/15	0.60%
2015/16	1.50%

There is the prospect of the 'Funding for Lending Scheme' impacting further on rates and suppressing returns to levels below those quoted above. This results from institutions being able to access low cost funding from the Bank of England under the scheme reducing the rates they in turn need to offer to investors.

Investment treasury indicator and limit – No principal funds will be invested for periods in excess of 364 days. Any deposit placed under the cash backed LAMS scheme is considered to be outside the scope of this constraint as outlined in Section 4.2 above.

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

4.5 End of year investment report

At the end of the financial year, a report on investment activity will be presented to the Executive as part of the Annual Treasury Report.

5 Appendices

1. Interest rate forecasts
2. Economic background
3. Treasury management practice 1 – credit and counterparty risk management
4. Approved countries for investments
5. Treasury management scheme of delegation
6. The treasury management role of the section 151 officer

5.1 APPENDIX: Interest Rate Forecasts 2013 - 2016

Sector's Interest Rate View	Now	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%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.38%	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	0.50%	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	0.83%	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	1.88%	1.80%	1.80%	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%	2.50%	2.60%	2.80%	3.00%
10yr PWLB Rate	3.09%	2.90%	2.90%	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%	3.60%	3.80%	3.90%	4.10%
25yr PWLB Rate	4.24%	4.10%	4.10%	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%	4.60%	4.80%	4.90%	5.00%
50yr PWLB Rate	4.39%	4.20%	4.20%	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%
Bank Rate														
Sector's View	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%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate														
Sector's View	1.88%	1.80%	1.80%	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%	2.50%	2.60%	2.80%	3.00%
UBS	1.88%	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.88%	1.55%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	-	-	-	-	-
10yr PWLB Rate														
Sector's View	3.09%	2.90%	2.90%	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%	3.60%	3.80%	3.90%	4.10%
UBS	3.09%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	-	-	-	-	-
Capital Economics	3.09%	2.55%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	-	-
25yr PWLB Rate														
Sector's View	4.24%	4.10%	4.10%	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%	4.60%	4.80%	4.90%	5.00%
UBS	4.24%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	-	-	-	-	-
Capital Economics	4.24%	3.70%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-	-	-	-	-
50yr PWLB Rate														
Sector's View	4.39%	4.20%	4.20%	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%
UBS	4.39%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	-	-	-	-	-
Capital Economics	4.39%	4.00%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

5.2 APPENDIX: Economic Background

The Global economy

The Eurozone debt crisis has continued to cast a pall over the world economy and has depressed growth in most countries. This has impacted the UK economy which is unlikely to grow significantly in 2012 and is creating a major headwind for recovery in 2013. Quarter 2 of 2012 was the third quarter of contraction in the economy; this recession is the worst and slowest recovery of any of the five recessions since 1930. A return to growth @ 1% in quarter 3 in unlikely to prove anything more than a washing out of the dip in the previous quarter before a return to weak, or even negative, growth in quarter 4.

The **Eurozone sovereign debt crisis** has abated somewhat following the ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bailout. The immediate target for this statement was Spain which continues to prevaricate on making such a request and so surrendering its national sovereignty to IMF supervision. However, the situation in Greece is heading towards a crunch point as the Eurozone imminently faces up to having to relax the time frame for Greece reducing its total debt level below 120% of GDP and providing yet more financial support to enable it to do that. Many commentators still view a Greek exit from the Euro as inevitable as total debt now looks likely to reach 190% of GDP i.e. unsustainably high. The question remains as to how much damage a Greek exit would do and whether contagion would spread to cause Portugal and Ireland to also leave the Euro, though the longer a Greek exit is delayed, the less are likely to be the repercussions beyond Greece on other countries and on EU banks.

Sentiment in financial markets has improved considerably since this ECB action and recent Eurozone renewed commitment to support Greece and to keep the Eurozone intact. However, the foundations to this "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse.

The US economy has only been able to manage weak growth in 2012 despite huge efforts by the Federal Reserve to stimulate the economy by liberal amounts of quantitative easing (QE) combined with a commitment to a continuation of ultra low interest rates into 2015. Unemployment levels have been slowly reducing but against a background of a fall in the numbers of those available for work. The fiscal cliff facing the President at the start of 2013 has been a major dampener discouraging business from spending on investment and increasing employment more significantly in case there is a sharp contraction in the economy in the pipeline. However, the housing market does look as if it has, at long last, reached the bottom and house prices are now on the up.

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

The UK economy

The Government's austerity measures, aimed at getting the public sector deficit into order over the next four years, now look as if they will fail to achieve their objectives within the original planned timeframe. Achieving this target is dependent on the UK economy growing at a reasonable pace but recession in the Eurozone, our biggest trading partner, has depressed growth whilst tax receipts have not kept pace with additional welfare benefit payments. It will be important for the Government to retain investor confidence in UK gilts so there is little room for it to change course other than to move back the timeframe.

Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is seen as a safe haven from Eurozone debt. There is, though, little evidence that consumer confidence levels are recovering nor that the manufacturing sector is picking up. On the positive side, growth in the services sector has rebounded in Q3 and banks have made huge progress since 2008 in shrinking their balance sheets to more manageable levels and also in reducing their dependency on wholesale funding. However, availability of credit remains tight in the economy and the Funding for Lending scheme, which started in August 2012, has not yet had the time to make a significant impact. Finally, the housing market remains tepid and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth. Economic growth has basically flat lined since the election of 2010 and, worryingly, the economic forecasts for 2012 and beyond were revised substantially lower in the Bank of England Inflation quarterly report for August 2012 and were then further lowered in the November Report. Quantitative Easing (QE) was increased again by £50bn in July 2012 to a total of £375bn. Many forecasters are expecting the MPC to vote for a further round of QE to stimulate economic activity regardless of any near-term optimism. The announcement in November 2012 that £35bn will be transferred from the Bank of England's Asset Purchase Facility to the Treasury (representing coupon payments to the Bank by the Treasury on gilts held by the Bank) is also effectively a further addition of QE.

Unemployment. The Government's austerity strategy has resulted in a substantial reduction in employment in the public sector. Despite this, total employment has increased to the highest level for four years as over one million jobs have been created in the private sector in the last two years.

Inflation and Bank Rate. Inflation has fallen sharply during 2012 from a peak of 5.2% in September 2011 to 2.2% in September 2012. However, inflation increased back to 2.7% in October though it is expected to fall back to reach the 2% target level within the two year horizon.

AAA rating. The UK AAA sovereign rating has recently been downgraded by Moody's. The credit rating agencies will be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years.

Sector's forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains relatively fragile and whilst there is still a broad range of views as to potential performance, expectations have all been downgraded during 2012. Key areas of uncertainty include:

- the potential for the Eurozone to withdraw support for Greece at some point if the costs of such support escalate were to become prohibitive, so causing a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;

- inter government agreement on how to deal with the overall Eurozone debt crisis could fragment; the impact of the Eurozone crisis on financial markets and the banking sector;

- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to manufactured goods;
- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that are unlikely to be achieved;
- the risk of the UK's main trading partners, in particular the EU and US, falling into recession ;
- stimulus packages failing to stimulate growth;
- elections due in Germany in 2013;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.
- the potential for action to curtail the Iranian nuclear programme
- the situation in Syria deteriorating and impacting other countries in the Middle East

The focus of so many consumers, corporates and banks on reducing their borrowings, rather than spending, will continue to act as a major headwind to a return to robust growth in western economies.

Given the weak outlook for economic growth, Sector sees the prospects for any changes in Bank Rate before 2015 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. The interest rate forecast in this report represents a balance of downside and upside risks. The downside risks have already been commented on. However, there are specific identifiable upside risks as follows to PWLB rates and gilt yields, and especially to longer term rates and yields: -

- UK inflation being significantly higher than in the wider EU and US causing an increase in the inflation premium in gilt yields
- Reversal of QE; this could initially be allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held
- Reversal of Sterling's safe haven status on an improvement in financial stresses in the Eurozone
- Investors reverse de-risking by moving money from government bonds into shares in anticipation of a return to worldwide economic growth
- A UK credit rating downgrade (Moody's announced a downgrade in February 2013 following a review of the UK AAA rating).

5.3 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 364 days**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. Examples include gilts, supranational bonds and fixed term deposits with banks and building societies with a duration greater than 1 year. *On current plans it is not expected that the Council will utilise any non-specified investments.*

For specified investments the criteria, time limits and monetary limits applying to institutions or investment types are:

	Minimum credit criteria / colour band	**£ limit per institution**	**Max. maturity period**
DMADF – UK Government	N/A	**Unlimited**	**6 months**
UK Government Treasury blls	UK sovereign rating	£2.5m	1 – 6 months
Money market funds (CCLA Public Sector Deposit Fund only)	AAA	£1m	Liquid
Principal Local authorities	N/A	£3m (£6m LCC)	364 days
Term deposits with designated UK banks and building societies	Blue Orange Red Green No Colour	Range between £2.5m and £5m (£5m restricted to Lloyds TSB Group as banker to the Council)	Up to 364 days Up to 364 days Up to 6 Months Up to 3 months Not for use
Term deposits with Non-UK banks meeting approved credit criteria	Red Green	£2m £1m	Up to 6 months Up to 3 months
Local Authority Mortgage Scheme. Under this scheme the Council may be required to place funds on deposit for a period of up to 5 years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified / non specified categories.			

5.4 APPENDIX: Approved countries for investments

Based on Fitch Long Term Ratings as at 22nd February 2013

AAA

- Australia
- Canada
- Denmark
- Finland
- France
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.K.
- USA

AA+

- Hong Kong

5.5 APPENDIX: Treasury management scheme of delegation

(i) Full Council

- Initial approval and adoption of Treasury Management Policy Statement and any subsequent revisions
- Approval of Annual Treasury Management Strategy / Annual Investment Strategy and policy on Minimum Revenue Provision (i.e. this report) and consideration and approval of any in year changes.

(ii) Executive

- Annual Treasury Management Outturn Report
- Mid-year Treasury Management Report

(iii) Accounts and Audit Committee

- Approval of /amendments to the Council's adopted treasury management practices;
- Receiving and reviewing regular monitoring reports and acting on recommendations;
- Scrutiny of treasury management performance and strategy.

(iv) Chief Finance Officer (Head of Central Services)

- To manage internal capital provisions and reserves and to supervise the investment of Council monies in accordance with the approved Treasury Management Strategy.

5.6 APPENDIX: The treasury management role of the section 151 officer

The S151 (responsible) officer at Pendle is the Head of Central Services

Day to day management of the Council's treasury management activities rests with the Head of Central Services. Within the overall Scheme of Delegation, this role is responsible for:

- 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.