South Bucks
District Council

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DEMOCRATIC AND ELECTORAL SERVICES

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Dear Councillor

E- RESOURCES POLICY ADVISORY GROUP

The Portfolio Holder has agreed to arrange an e-Resources PAG, with comments being sent via email. Please can members send their comments by Wednesday 28 January 2015.

Yours faithfully

Jim Burness

Director of Resources

To: The Resources Policy Advisory Group

Mr D Smith
Mr Anthony
Mr Chhokar
Mr Harding
Mr Hardy
Mr Hollis
Mr Jones
Mr Kelly

Declarations of Interest

Any Member is reminded of the requirement to declare if he/she has a personal interest in any item of business, as defined in the Code of Conduct. If that interest is a prejudicial interest as defined in the Code the Member should not submit comments.

E-PAG AGENDA

(Pages)

1. **Treasury Management Strategy 2015/2016**

To consider report of the Director of Resources. **(1 - 12)**

Appendix A **(13 - 22)**
Appendix B **(23 - 28)**
Appendix C **(29 - 32)**
Appendix D **(33 - 34)**

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SUBJECT:	Treasury Management Strategy 2015/2016
REPORT OF:	Resources Portfolio Holder – Cllr D Smith
RESPONSIBLE OFFICER	Director of Resources
REPORT AUTHOR	Jim Burness jim.burness@southbucks.gov.uk
WARD() AFFECTED	All

1. Purpose of Report

1.1. To advise the Portfolio Holder on the Treasury Management Strategy & Annual Investment Strategy that should be adopted by the Council for 2015/2016.

2.

The PAG is requested to

1. Advise the Portfolio Holder on the Treasury Management Strategy to recommend to Cabinet and Council, including : Approving the following appendices:

   - Appendix A the Annual Investment Strategy.
   - Appendix C the Prudential Indicators, including the borrowing limits.
   - Appendix D approve the MRP method to be used in 2015/16.

2. Advise the Portfolio Holder that because of the level of capital balances held that the Council remain a debt free authority.

3. Executive Summary

3.1 The Council is required to formally review its treasury management policies each year as part of determining what level of returns will be achieved from investments. The format of the treasury management policies is defined by the Code of Practise adopted by the Council, and is required to be approved by the Council on recommendation from the Cabinet.

3.2 The level of returns will be determined in the light of assessments of interest rates and available cash balances.

4. Content

4.1. The Council adopted the CIPFA code of practice on Treasury Management in June 2002, which includes the creation of a Treasury Management Strategy, which sets out the policies, and objectives of the Council's treasury management activities for the year ahead.

4.2. The Local Government Act 2003 requires the Council to have regard to the Prudential code and to set Prudential Indicators for the next 3 years to ensure that the Council's capital investments plans are affordable, prudent and sustainable.

4.3. The Act requires the Council to set out its Treasury Strategy and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

4.4. It is a statutory requirement under section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, section 32 requires a local authority to calculate its budget requirements for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- Loss of investment interest caused by the use of capital receipts to finance additional capital expenditure.

- Any increases in running costs from new capital projects.

Are limited to a level which is affordable within the projected income of the Council for the foreseeable future as part of the Council's overall Financial Strategy.

4.5. The DCLG's investment guidance states that authorities could combine the Treasury Strategy Statement and the Annual Investment Strategy (AIG) into one report. The Treasury Management Strategy 2015/16 document is attached to this report.

4.6. Following consideration of relevant information officers proposed a target figure for investment returns for 2015/2016 to be £400,000. This reflects the latest interest rate forecasts. This report seeks approval to the Strategy to achieve this target.

Treasury Management Strategy 2015/16

4.7. The Treasury Management Strategy 2015/16 attached to this report sets out the target for investment returns for 2015/16 and how this will be achieved against the background for the economy and the prospects for interest rates.

4.8 The majority of interest is generated by Officers placing money in fixed deposits. The current policy is to stay relatively short on these investments in order to have liquid funds available to take advantage of investment opportunities and when interest rates begin to rise and to have cash available should any opportunities in the type of corporate bonds that the Council are looking for become available.

4.9 Current market returns on cash investments are historically low and the likelihood is that this will continue for some years to come even if rates start to rise in 2015. This was initially primarily a result of the Funding for Lending Scheme and the Quantitative Easing strategy followed by the Bank of England which has depressed interest rates, but going forward sensitivity about the sustainability of the recovery and the weakness of growth in Europe is likely to keep rates low.

4.10 In 2013/14 and 2014/15 the Council has had a larger capital programme than it has had for many years mainly due to the capital expenditure on the new refuse & recycling arrangements and the works at Dropmore Road Depot. This has led to a material reduction in core cash balances that are available for investment and subsequently a reduction in interest returns.

4.11 In summary the Council is unlikely to see any growth in its investment income due to reduced cash reserves and the fact that interest rates, even if they do increase in 2015, are likely to remain below the historic average for the foreseeable future.

4.12 The proposed policy therefore for the coming year is to extend the duration of the investment portfolio, reducing the level of short term balances if possible when the differential between short and medium term rates return more to the historic norm. The policy will also aim to increase the number of counterparties. Diversifying the number of counterparties will include considering corporate bonds and certificates of deposit. Based upon this policy it is thought to be realistic to set the estimated return from investments for 2015/16 at £400,000.

Banking Services

4.13 The Council is in the process of changing its banking services from Nat West to Barclays, and this will be completed by February 2015.

4.14 This will mean that South Bucks and Chiltern will have the same banking provider, which will support the efficiencies available from having set up a joint finance team.

5. Consultation

5.1 Consultation is with the PAG within the framework set by the Code of Practise.

6. Options

6.1 The framework set by the Code of Practise means that options effectively relate to the judgements and risk assessments made when finalising the Strategy around likely returns and the level of available cash balances.

7. Corporate Implications

7.1. The budget for investment interest was set as £550,000 for 2014/15. Current estimated returns shows that there will a shortfall against the budget of at least £100,000.

7.2. For 2015/16 investment income will be based on total core cash reserves of £12m reflecting the recent high level of capital expenditure and consequential reduction in available cash balances. In addition officers invest surplus cash flow during the year and estimated returns are based on short-term interest rates remaining within the range of 0.30% to 1.50%.

7.3. Based upon the recommendations outlined in the Treasury Management Strategy 2015/16 attached the estimated investment returns for 2015/16 is £400,000.

7.4. This target for investment income reflects the latest forecasts for interest rates. It is regarded as realistic and achievable. Loss of £37K of investment income is equal to £1 Council Tax on a band D property.

7.5. As with any budget based on forecasts of future interest rates there is a risk of variation due to factors outside of the Council's control. This risk will need to be taken into account in determining the level of reserves held by the authority.

7.6. As stated the investment returns are based upon a core level of balances for 2015/16 of £14m. The estimated capital programme shows that this is realistic based on the latest programme. It is because of the level of balances that the Council hold that it will remain a debt free authority.

8. Links to Council - Business Plan

8.1. The Council's Treasury Management Strategy is a key element to the Financial Strategy, which in turn feeds into the prudent use of Resources, one of the Council's Management Principles.

9. Next Steps

- Following views from the PAG the Strategy will be considered by the Cabinet in February.
- Cabinet will recommend to Council the Strategy
- The implementation and monitoring of the strategy and policy will be undertaken by reports to the Resources PAG.

Background Papers:	**None**

South Bucks District Council

Treasury Management Strategy

2015/2016

1. Background

1.1. The Council adopted the CIPFA code of practice on Treasury Management in June 2002, which includes the creation of a Treasury Management Strategy, which sets out the policies, and objectives of the Council's treasury management activities for the year ahead. For Members information the requirements of the Code are detailed below.

1.2 The Code is built largely on what was recommended practise in the previous version, but does place greater or new emphasis in certain key areas. The main points in the new Code are as follows:-

a) All councils must formally adopt the revised Code and four clauses, these are shown as at Appendix A which also sets out the scheme of delegation and the treasury management role of the section 151 officer.

b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities. This is consistent with the approach always adopted by this Council.

c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.

d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation. This is something the Council has always been very clear about, in that whilst it uses advisers and external sources of information, that it is the officers and members of the authority who are accountable for policy and decisions.

e) Credit ratings should be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on Government support for banks and credit ratings of that Government support.

f) Councils need a sound diversification policy with high quality counterparties and should consider setting country, sector and group limits.

g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme. As a debt free authority this is not an issue that arises for the Council. The Council is required to review its debt free status each year. The option of borrowing funds to finance additional capital expenditure could be considered in the future as a means of enabling more costly schemes, which would otherwise not be affordable, to take place, but it is not felt to be necessary for current planned expenditure.

h) The main annual treasury management reports must be approved by full Council.

i) There needs to be, at a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved. For South Bucks DC this requirement is met by the regular reports to the Resources Portfolio Holder.

j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body. For South Bucks DC this is carried out by the Resources PAG.

k) Treasury Management performance and policy setting should be subjected to prior scrutiny. This is achieved via the regular discussions on Treasury Management at the RPAG.

l) Members should be provided with access to relevant training. This has been provided in the past by the Council's treasury management advisers.

m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

n) Responsibility for these activities must be clearly defined within the organisation.

o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices).

1.3 This strategy statement has been prepared in accordance with the Code. As in previous years the Council's Treasury Management Strategy will be approved annually by the full Council. In addition there will also be regular monitoring reports to the Resources PAG one of which will be the annual report. In addition the Resources Portfolio Holder will be emailed each month with information showing where the Council's investment portfolio has been invested. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

1.4 The Council will adopt/reaffirm the following reporting arrangements in accordance with the requirements of the revised Code:-

Area of Responsibility	Reporting Arrangements	Frequency
Treasury Management Policy	Resources PAG /Cabinet/Council	Reviewed annually.
Treasury Management Strategy Annual Investment Strategy MRP policy	Resources PAG /Cabinet/Council	Annually before the start of the financial year
Treasury Management Strategy Annual Investment Strategy MRP policy – in year report	Resources PAG /Cabinet	Appropriate report to RPAG
Treasury Management Strategy Annual Investment Strategy MRP policy – updates or revisions at other times	Resources PAG /Cabinet/Council	As appropriate
Annual Treasury Outturn Report	Resources PAG /Cabinet	Annually by 30th September after the end of the year
Monitoring Reports	Resources PAG /Cabinet	Regularly
Treasury Management Practices	Resources PAG /Cabinet/Council	Annually
Investment Portfolio Detail	Resources Portfolio Holder	Monthly
Scrutiny of treasury management strategies & performance	Resources PAG	Ongoing but with particular focus when considering annual Strategy

1.5. The Local Government Act 2003 and supporting regulations requires the Council to have regard to the CIPFA Prudential code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investments plans are affordable, prudent and sustainable.

1.6. The Act requires the Council to set out its Treasury Strategy and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.7. It is a statutory requirement under section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, section 32 requires a local authority to calculate its budget requirements for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenues from :

- Loss of investment interest caused by the use of capital receipts to finance additional capital expenditure.
- Any increases in running costs from new capital projects.

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

1.8. The DCLG's investment guidance states that authorities could combine the Treasury Strategy Statement and the Annual Investment Strategy (AIS) into one report and the AIS supporting this Strategy Statement is attached as Appendix A.

1.9. The Council employs Capita Asset Services, Treasury Solutions as its external treasury management consultants. 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 external service providers. It is recognised that there is value in employing an external provider in order to access specialist skills and resources. The Council contract with Capita Asset Services is a joint one with Chiltern District Council for a three year period and commenced on 1st July 2013.

1.10. Following consideration of the Council's future funding requirements and economic forecasts and other relevant information, the proposed target figure for investment returns for 2015/2016 is £400,000.

1.11. This Strategy seeks approval for this target level of return, how realistic it is and sets out how it can be achieved.

2. Current Portfolio Position

2.1. Investment Criteria – Investment income is mainly generated by Officers placing money in callable or fixed deposits with approved counter parties. When making the decision to invest Officers take into account security, liquidity and yield which are inter-related and the balance of the three is determined by the authority's needs and risk appetite. Decisions to invest are made following discussion between the Director of Resources and the Principal Accountant (Capital & Treasury) both of whom have sufficient experience in this area. The discussion on investment is based upon information that is available from the Council's treasury consultants, Capita Asset Services, and brokers acting in the local authority money market, combined with general intelligence available from money market briefings made available to the authority. The approved for in house

counterparty investments made by Officers as part of the Treasury Management Strategy is as follows:

	Duration	Maximum Amount	Fitch Rating	Comment
UK Institutions	Up to 5 years	£5m	A- or better	
	Up to 3 years	£3m	BBB+ or better	
Non UK Institution	Up to 3 years	£2m	A- or better	Sovereignty rating AA or better
Corporate Bonds/Bond Funds	Up to 5 years	£5m	A- or better	
Other Approved Investments	Up to 3 years	£1m	A- or better	Includes Money Market Funds

2.2 In recent years officers have been keeping under review the potential to diversify up to £5m of the investment portfolio into corporate bonds. This has focused on the non-financial sectors, in order to spread risk on the investments. However due to the effect that the Bank of England's Quantative Easing programme has had on bond yield, no investments with a sufficiently attractive return, duration, and counterparty credit rating have been identified.

2.3 A summary of the Council's current (at the end of October 2014) holdings of fixed deposits invested for a period in excess of one year is shown below:

	Credit Rating	Amount Loaned £	Interest Rate	Matures
UK Institutions - High				
(Max £5m)				
Lloyds Bank	A	1,000,000	2.85%	May 15
Lloyds Bank	A	1,000,000	3.07%	May 15
Barclays Bank	A	1,000,000	0.63%	Jun 15
Barclays Bank	A	1,000,000	3.05%	May 15
Halifax Bank of Scotland	A	1,000,000	0.6%	Feb 15
Royal Bank of Scotland	A	5,000,000	1.13%	Feb 17
Close Brothers	A	1,000,000	1.7%	Feb 16
Close Brothers	A	1,000,000	1.3%	Oct 16
Close Brothers	A	1,000,000	1.7%	Mar 16
UK Institutions - Low				
(Max £3m)	-	-	-	-
Non UK Institutions				
(Max £2m)	-	-	-	-
Other Approved Investments				
(Max £1m)				
UK Gilts	AAA	517,209	6%- 8.75%	Dec 15 – Jul 28
CDs	A	606,761	5.8%- 6.3%	Jun 21 – Feb 24
Money Market Funds	-	-	-	-
Total Deposits		14,123,970		

2.4 In addition the Officers invest short term cash flow. Short term reserves are required mainly in the last quarter of the year when council tax and grant payments tail off but precept payments continue. A summary of the Council's current short term cash holdings with a maturity of less than one year is shown below.

	Fitch	Amount £	Interest Rate	Period
Nat West 95 day notice	A	1,000,000	0.6%	Rolling 95 day period
Nat West SIB A/c	A	9,067,000	0.3%	On call, instant access
Total		10,067,000		

The high level of short term cash investments with NatWest reflects the fact that they have been the Council's banker for a number of years, however this arrangement will change from February 2015 when the Council's banker will become Barclays. In advance to that change a proportion of this short term cash will be placed in a range of other short term investments to increase the diversity of the portfolio.

3. Prospects for Interest Rates and Economic Background

3.1 Part of the service provided by the Council's treasury management advisers is to assist the Council to formulate a view on interest rates. The following table gives the Capita Asset Services central view on the bank rate and short term money rates.

	2015/16				2016/17		2017/18	
	Q1	Q2	Q3	Q4	Q1	Q4	Q1	Q4
Bank Rate	0.50%	0.75%	1.00%	1.00%	1.25%	1.50%	1.75%	2.50%
3 M LIBID	0.50%	0.60%	1.10%	1.30%	1.40%	2.10%	2.10%	2.60%
6M LIBID	0.70%	1.00%	1.20%	1.40%	1.50%	2.20%	2.30%	2.80%
12M LIBID	0.90%	1.20%	1.40%	1.70%	1.80%	2.30%	2.40%	3.00%

3.2 Capita Asset Services forecast that by the end of the March 2018 quarter the bank rate will be 2.5% with LIBID rates at 2.6 % 3 month, 2.8 % 6 months and 3.0% 12 months. A detailed view of the current economic background is shown in Appendix B. The key points that influence the Invest Strategy are as follows:

- The UK economy is showing signs of recovery but is still burdened with consumer debt, which will mean any increase in rates will be slow and incremental. The economy needs rebalancing to be less dependent on consumer expenditure and to increase productivity if growth is to be robust and sustainable.
- The UK is vulnerable to external factors, primarily the Euro Zone economy and the situation in Eastern Europe and the Middle East.
- The Euro Zone is showing low or negative growth, and there are still significant risks over a number of individual economies (e.g. Italy).
- Uncertainty in markets usually provokes a shift from equities to bonds/gilts, which acts to depress rates.

4 Achieving the investment target in 2015/16

4.1 The Council has as part of the funding strategy for its revenue budget an assumption that interest earned on cash investments will be used to support the council tax, and by

implication that the Council will continue to be debt free. For the current financial year the budget for investment income is £550k.

4.2 There are two elements to the Council's cash balances. Firstly there is the element that relates to the Council's working balance and from its cashflow over the course of the year. These cash balances need to be kept in a very liquid form with investments of one year or less duration. Secondly there is the element of cash retained for investment purposes or to finance capital expenditure, this can be invested for longer periods and does not need to be so liquid. Broadly speaking this second element is around £14m, and has reduced significantly over the last two years as a result of the higher level of capital expenditure.

4.3 In undertaking investments the Treasury Management Code of Practice sets out three important principles to have regard to:

- Security of Capital
- Liquidity
- A return consistent with these principles.

In recent years since the Icelandic Banks issue, authorities have been encouraged to see security as the most important principle.

4.4 The Council's current core investment portfolio is split between short term investments of up to one year and those with a longer duration of up to five years.

4.5 Current market returns on cash investments are historically low and the likelihood is that this will continue for some years to come even if rates start to rise in 2015. This was initially primarily a result of the Funding for Lending Scheme and the Quantitative Easing strategy followed by the Bank of England which has depressed interest rates, but going forward sensitivity about the sustainability of the recovery and the weakness of growth in Europe is likely to keep rates low.

4.6 The depressed interest rate market and the issues around having a range of acceptable counterparties have proved to be a problem when the longer term investments that the Council have within its investment portfolio reach their maturity. At a time where interest rates have been and continue to be low these longer term investments which were made when rates were considerably higher have helped to underpin the return on investments each year. However it is proving difficult in the current climate to reinvest these at a return anywhere near to that which had previously been achieved for anything long term and subsequently these maturities have been reinvested on a short term basis only.

4.7 As a result of the period of low interest Members considered alternative investments to cash as part of the Treasury Management Strategy 2013/14. This included investigating corporate bonds in the non-financial sector as possible additional investment opportunities. There have been few bonds that have become available under the extended search that meet the Council's investment criteria however nothing with an effective interest rate (the calculated interest rate that the Council would receive taking into account the purchase price of the bond) that have been particularly appealing.

4.8 In summary the Council is unlikely to see any growth in its investment income due to reduced cash reserves and the fact that interest rates, even if they do increase in 2015, are likely to remain below the historic average for the foreseeable future.

4.9 The proposed policy therefore for the coming year is to extend the duration of the investment portfolio, reducing the level of short term balances if possible when the differential between short and medium term rates return more to the historic norm. The policy will also aim to increase the number of counterparties. Diversifying the number of

counterparties will include considering corporate bonds and certificates of deposit. Based upon this policy it is thought to be realistic to set the estimated return from investments for 2015/16 at £400,000.

5 Stoke Poges Memorial Gardens Fund

5.1 The investment returns from the fund is no longer credited directly to the Stoke Poges Memorial Gardens Fund cost centre but has been incorporated with all of the Council's other investment returns. The current value of this element of the overall investment portfolio is £1.124m.

6 Financial Summary & Risks

6.1 The budget for investment interest was set as £550,000 for 2014/15. Current estimated returns show that there is likely to be a shortfall against the current year's budget of £100,000.

6.2 For 2015/16 investment income will be based on total core cash reserves of £14m. In addition officers invest surplus cash flow during the year and estimated returns are based on short-term interest rates remaining within the range of 0.30% to 1.50%.

6.3 Based upon the recommended Strategy outlined above the estimated investment returns for 2015/2016 is £400,000.

6.4 This target for investment income reflects the latest forecasts for interest rates. It is regarded as realistic and achievable. Loss of £37,000 of investment income is equal to £1 council tax on a band D property.

6.5 As stated the investment returns are based upon a core level of balances for 2015/16 of £14m. The estimated capital programme shows that this is realistic based on the current level of approved expenditure. It also assumes the Council will remain a debt free authority.

6.6 As with any budgets based on forecasts of future interest rates there is a risk of variation due to factors outside of the Council's control. This risk will need to be taken into account in determining the level of revenue reserves held by the authority.

6.7 The Local Government Act 2003 sets out the new capital regulations and specifies that local authorities must comply with the Prudential Code produced by CIPFA. The Council has a duty to determine an affordable borrowing limit. As a debt free authority this would be nil, however the regulations also incorporate the limit for temporary borrowing any temporary borrowing since 1990/1991 it is necessary under statute to approve a limit in case the circumstances arise should it be required. It is recommend that Members approve an authorised borrowing limit of £3 million and an operational borrowing limit of £3 million, these together with other prudential indicators that the Council are required to set under the code are shown at Appendix C, and Appendix D covers the technical requirement in respect of calculating the minimum revenue provision.

Appendices

A – Annual Investment Strategy Policies
B – Economic Background
C – Prudential Indicators
D – Minimum Revenue Provision

APPENDIX B

ECONOMIC BACKGROUND

UK Economy

Strong UK GDP quarterly **growth** of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1, 0.9% in Q2 and a first estimate of 0.7% in Q3 2014 (annual rate 3.1% in Q3), means that the UK will have the strongest rate of growth of any G7 country in 2014. It also appears very likely that strong growth will continue through the second half of 2014 and into 2015 as forward surveys for the services and construction sectors are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though recent figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance.

This overall strong growth has resulted in **unemployment** falling much faster through the initial threshold of 7%, set by the **Monetary Policy Committee (MPC)** last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in **inflation** (CPI) during 2014 after being consistently above the MPC's 2% target between December 2009 and December 2013. Inflation fell to 1.2% in September, a five year low. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1% and then to remain near to, or under, the 2% target level over the MPC's two year ahead time horizon. Overall, markets are expecting that the MPC will be cautious in raising **Bank Rate** as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The return to strong growth has also helped lower forecasts for the increase in **Government debt** by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014

Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

The Eurozone (EZ).

The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt).

Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US. Greece remains particularly vulnerable but has made good progress in reducing its annual budget deficit and in returning, at last, to marginal economic growth. Whilst a Greek exit from the Euro is now improbable in the short term, some commentators still view the inevitable end game as either being another major right off of debt or an eventual exit.

There are also 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 24% and unemployment among younger people of over 50 – 60%. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. Any loss of market confidence in the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

USA.

The Federal Reserve started to reduce its monthly asset purchases of $85bn in December 2013 by $10bn per month; these ended in October 2014, signalling

confidence the US economic recovery would remain on track. First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in Q2 to 4.6% (annualised). The first estimate of Q3 showed growth of 3.5% (annualised). Annual growth during 2014 is likely to be just over 2%.

The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions. It is currently expected that the Fed. will start increasing rates in mid 2015.

China.

Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has been mixed. There are also concerns that the Chinese leadership have only started to address 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 concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan.

Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth. In Q2 growth was -1.8% q/q and -7.1% over the previous year. The Government is hoping that this is a temporary blip.

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 to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

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

The overall balance of risks to economic recovery in the UK is currently evenly weighted. 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.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis, or a break-up of the EZ, but rather that there will be a managed, albeit painful and tortuous, resolution of the debt crisis where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be tepid for the next couple of years and some EZ countries experiencing low or negative growth, will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the large countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Downside risks currently include:

- The situation over Ukraine poses a major threat to EZ and world growth if it was to deteriorate into economic warfare between the West and Russia where Russia resorted to using its control over gas supplies to Europe.

- Fears generated by the potential impact of Ebola around the world

- UK strong economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014.

- A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth beyond 2014.

- Weak growth or recession in the UK’s main trading partner - the EU, inhibiting economic recovery in the UK.

- 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.

- Recapitalisation of European banks requiring considerable government financial support.

- Lack of support by populaces in Eurozone countries for 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.

- Italy: the political situation has improved but it remains to be seen whether the new government is able to deliver the austerity programme required and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.

- France: after being elected on an anti austerity platform, President Hollande has embraced a €50bn programme of public sector cuts over the next three years. However, there could be major obstacles in implementing this programme. Major overdue reforms of employment practices and an increase in competiveness are also urgently required to lift the economy out of stagnation.

- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.

- Heightened political risks in the Middle East and East Asia could trigger safe haven flows back into bonds.

- There are also increasing concerns at the reluctance of western central banks to raise interest rates significantly for some years, plus the huge QE measures which remain in place (and may be added to by the ECB in the near future). This has created potentially unstable flows of liquidity searching for yield and, therefore, heightened the potential for an increase in risks in order to get higher returns. This is a return to a similar environment to the one which led to the 2008 financial crisis.

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

- A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds into equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

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PRUDENTIAL CODE & INDICATORS STATEMENT

The Prudential Code for Capital Finance in Local Authorities was developed by CIPFA to support local authorities with the management of their capital finance and investment programmes. The key objectives of the Prudential Code are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable. A further key objective is to ensure that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability. The Prudential Code also has the objectives of being consistent with and supporting local strategic planning, local asset management planning and proper option appraisal.

To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used and the factors that must be taken into account. The indicators will be monitored during the year and the final position at the year end compared to the forecast.

Prudential Indicators of Affordability

1.Capital Expenditure

The first prudential indicator for affordability gives details of the total capital expenditure plans. This is to help ensure that these are reasonable given the resources of the council.

	2013/14 Actual £'000	2014/15 Forecast £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Capital Expenditure	3,956	3,786	1,050	913	742

For SBDC the capital programme will continue to be fully funded from capital receipts and Government grant, and the above capital expenditure plans will not reduce the level of those receipts to below that assumed in forecasting future investment income.

2.Ratio of financing costs to net revenue income stream

The second indicator shows how much of a councils revenue budget has to be allocated towards interest payments, or for a debt free authority such as SBDC how much investment income contributes to the budget.

	2013/14 Actual £'000	2014/15 Forecast £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Financing Costs (1)	842	700	550	500	450
Net Revenue Stream	7,569	6,873	6,849	6,577	6,491
Ratio	(11.12%)	(10.18%)	(8.03%)	(7.60%)	(6.93%)

(1) ie net investment income

As SBDC is debt free – income from investments far outweighs any short term borrowing costs, therefore the ratio of financing costs to revenue income stream (Government grant and Council tax payers) will be negative.

3. Incremental Impact on Council Tax

The next indicator assesses the impact of the capital programme on the revenue budget.

For SBDC the size of the capital programme has an effect on the Council's revenue budget (and hence Council Tax) in two ways.

Firstly each pound spent on the capital programme reduces the amount of capital reserves, which in turn reduces the Council's investment holdings and thus the revenue interest earned by the Council. Based on current investment rates, increasing the overall capital programme by £100,000 will reduce annual interest by and thus increase the revenue budget by £1,000. Similarly reducing the overall capital programme by £100,000 will increase annual interest by and thus reduce the revenue budget by £1,000. £1,000 is equivalent to approximately 3.5p on the average band D Council Tax.

Secondly additional capital expenditure can result in additional revenue maintenance costs, for instance a new piece of ICT equipment is likely to required additional annual maintenance and support.

4. Capital Financing Requirement

This indicator provides details of an authority's underlying need to borrow. For debt free authorities this should be nil.

	2013/14 Actual £'000	2014/15 Forecast £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
SBDC Capital Financing Requirement	0	0	0	0	0

Furthermore the SBDC capital financing requirement will always remain nil whilst capital expenditure if fully funded from capital receipts and Government Grant.

5. Authorised Temporary Borrowing Limits

This indicator sets limits on how much SBDC can borrow.

	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000
Authorised Limit	3,000	3,000	3,000	3,000	3,000
Operational Limit	3,000	3,000	3,000	3,000	3,000

The Authorised Limit for South Bucks represents the maximum temporary borrowing limit. The Operational Limit focuses on the day to day treasury management activities of the authority and is set at a lower figure than the Authorised Limit because cash – flow variations may lead to the occasional (but not sustained) breeches of the operational limit.

Prudential Indicators for Prudence

1. Net Borrowing and The Capital Financing Requirement

The first prudential indicator for prudence is to ensure that in the medium term borrowing will only be used to fund capital expenditure. As SBDC does not borrow (except for short term cash flow requirements) then this indicator is met.

2. Treasury Management Indicator

The second indicator is whether or not the authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector. SBDC has done this and thus meets this indicator.

3. Upper limit for interest rate exposure.

The interest rates exposure indicators are designed to limit exposure to the effects of changes in interest rates. As a debt free authority these are set reasonably high to allow investment flexibility.

	2014/15	2015/16	2016/17	2017/18
Fixed Rate	100%	100%	100%	100%
Variable Rate	50%	54%	54%	54%

A minimum of £8 million is committed to be invested in fixed rate deposits during the whole of 2015/16, representing 46% of the total investments available. It has been assumed that the remaining balance of the Council's investments, 54%, is available to invest in variable rate investments.

4. Maturity Structure of Borrowings

This indicator is designed to reduce the risk of large sums of borrowings having to be repaid at the same time. However as a debt free authority SBDC will only ever have short term debt to cover cash flow shortfalls. As such for SBDC all borrowings shall be repayable within 12 months.

5. Upper limit for total principal sums invested for over 364 days.

Where a local authority invests, or plans to invest, for periods longer than 364 days, the local authority must set an upper limit for each forward financial year period for the maturing of such investments. This prudential indicator is referred to as prudential limits for principal sums invested for periods longer than 364 days. This indicator is designed to ensure that authorities always have sufficient funds to cover their cash flow needs and thus do not need to realise investments before they reach maturity.

As SBDC has cash reserves of over £16m it is able to invest longer term and thus has a high limit.

	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m
Upper Limit	17.5	15	15	15

The above upper limit figure has been calculated taking into account the maximum that could be available for investing in excess of 1 year allowing for the needs of short term cash flow and the use of capital receipts to fund capital expenditure. At present the Council has £14 million of investments which may mature in excess of 364 days.

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