1. Introduction Appendix 9

1.1 The CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to set the Treasury Management Strategy Statement (TMSS) for borrowing and to prepare an Investment Strategy each financial year. CIPFA has defined Treasury Management as:

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

1.2 This strategy takes into account the impact of the Council's Revenue Budget, Medium Term Capital Programme and the Balance Sheet position. The Prudential Indicators and the outlook for interest rates are also considered within the strategy.

1.3 The Treasury Management Strategy for 2015-16 covers the following areas:

- economic overview (section 2);
- the treasury position (section 3);
- the borrowing strategy to finance the capital plans (section 4);
- the investment strategy(section 5);
- the Minimum Revenue Provision (MRP) strategy(section 6); and
- policy on use of external service provider(section 7);

1.4 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. The Treasury Management Scheme of Delegation is shown in Appendix 1.

2. Economic Overview

2.1 The Council appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The Table 1 below gives the Capita Asset Services central view for short term (Bank Rate) and longer fixed interest rates.

Table 1

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2015	0.50	2.20	3.40	3.40
Jun 2015	0.50	2.20	3.50	3.50
Sep 2015	0.50	2.30	3.70	3.70
Dec 2015	0.75	2.50	3.80	3.80
Mar 2016	0.75	2.60	4.00	4.00
Jun 2016	1.00	2.80	4.20	4.20
Sep 2016	1.00	2.90	4.30	4.30
Dec 2016	1.25	3.00	4.40	4.40
Mar 2017	1.25	3.20	4.50	4.50
Jun 2017	1.50	3.30	4.60	4.60
Sep 2017	1.75	3.40	4.70	4.70
Dec 2017	1.75	3.50	4.70	4.70
Mar 2018	2.00	3.60	4.80	4.80

2.2 The Capita Asset Services view is that until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 and especially during 2014, to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive in indicating that growth prospects are strong for 2015, particularly in the services and construction sectors. However, growth in the manufacturing sector and in exports has weakened during 2014 due to poor growth in the Eurozone. There does need to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this initial stage in the recovery to become more firmly established.

2.3 One drag on the economy is that wage inflation has been lower than CPI inflation so eroding disposable income and living standards, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by warranting increases in pay rates.

2.4 In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen in the near future.The US, the main world economy, faces similar debt problems to 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.

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

- As for the Eurozone, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and a triple dip recession since 2008;
- Sovereign debt difficulties have not gone away and major concerns could return in respect of individual 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 to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2015/16 and beyond;
- Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. During July to October 2014, a building accumulation of negative news has led to an overall trend of falling rates;

3. Treasury Management Position

3.1 The Council's projected treasury portfolio position at 31 March 2015, with forward estimates is summarised in Table 2 below. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 2

Description	2014/15 Projected £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
External Borrowing				
Borrowing at 1 April	263	259	255	250
New Borrowing (assumed no new borrowing)	-	-	-	-
Actual borrowing at 31 March	**263**	**259**	**255**	**250**
CFR – the borrowing need	**291**	**309**	**310**	**319**
Under/(over) borrowing	**29**	**50**	**55**	**69**

3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The CFR together with usable reserves are therefore core drivers of the Council's treasury management activity. The Council's CFR is the total historical outstanding capital expenditure which has not yet been paid for from either through revenue or capital resources. Any capital expenditure, which has not immediately been paid for, will increase the CFR.

3.3 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 2015/16 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.

3.4 The Capital Finance Requirement will decrease as a result of the annual charge for repayment of debt in the coming years, combined with a series of longer-term loan redemptions. The Council is required to repay an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision – MRP), currently estimated to be £12m for 2015/16.

Do the Council need to borrow?

3.5 The Council's current strategy is to maintain external borrowing below the level of the CFR – known as internal borrowing. As at the end of 2014/15 the Council is projected to under borrowed by £29m. This reflects the policy of avoiding new borrowing by running down spare cash balances, which has served the Council well over the last few years. Officers continue to review the need to borrow taking into consideration the potential increases in borrrowing costs, the need to finance new capital expenditure, refinancing maturing debt, and the cost of carry that might incur a revenue loss between borrowing costs and investment returns.

3.6 Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer-term and maintain stability. Given the on-going cuts to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

3.7 Capital programme highlight that an additional £29.8m borrowing is required to finance the Council's capital programme in 2015/16. An analysis of the Council's balance sheet including usable reserves show these are sufficient to avoid externally borrowing during 2015/16. By essentially lending the Council's own surplus funds to itself, the Council will minimise borrowing costs and reduce overall treasury risk by reducing the level of external investments.

3.8 With official interest rates forecast to remain low, an internal borrowing strategy is most likely to be beneficial over the current three year capital programme period, it is however unlikely to be sustainable in the longer-term. The benefits of internally borrowing will be regularly monitored against the potential for incurring costs through deferring new external borrowing into future years when long-term borrowing rates are forecast to rise.

3.9 Future loans will be arranged giving consideration to the various debt repayment options, including Maturity, Annuity and Equal Instalments of Principal (EIP).

4. Borrowing Strategy

4.1 The Council's primary objective when borrowing longer term is to strike an appropriately low risk balance between securing low interest rates and achieving cost certainty over the period for which funds are required.

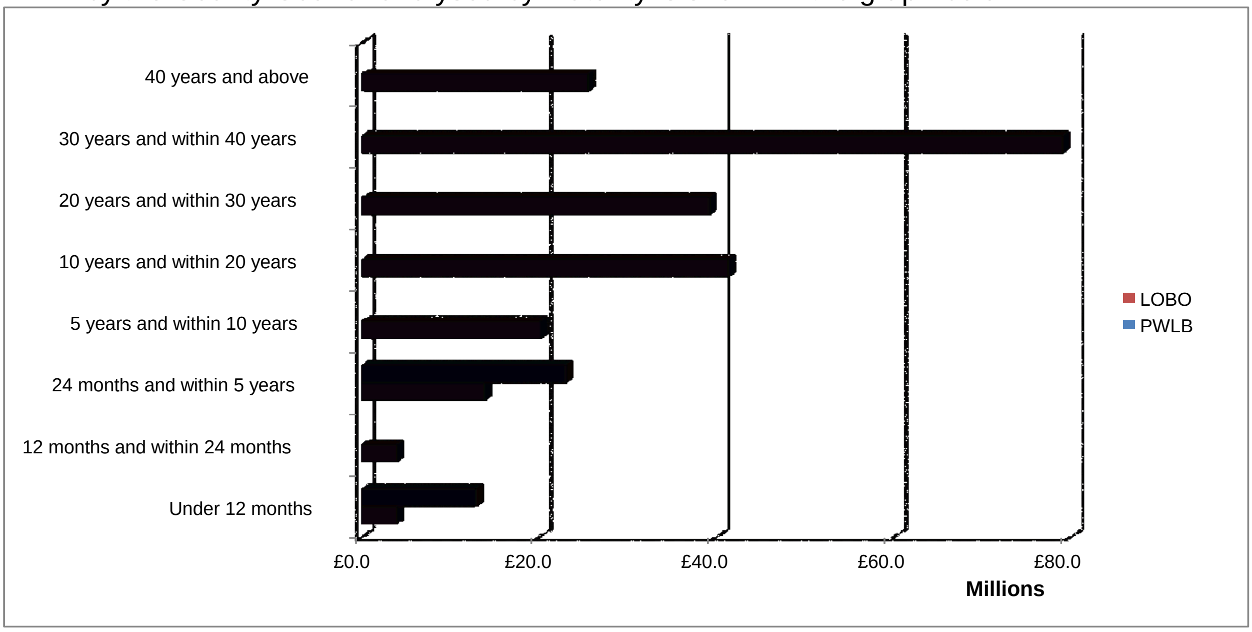
4.2 This treasury management strategy is prudent. External borrowing has been minimised to reduce cost of carry at a time when investment returns are low and counterparty risks continue to be relatively high, however as interest rates are low the Council may wish to take advantage of this by securing fixed rate funding.

4.3 The Council's long-term external borrowing (excluding PFI and finance leases) amounted to £262.9m at 31 March 2014 with majority sourced from the Public Works Loan Board (PWLB) at fixed interest rates of between 3.70% - 8.625%, with a weighted average rate of 5.20%. The PWLB allows local authorities to repay loans early and either pay a premium or obtain a discount according to a formula based on current interest rates.

4.4 With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to use internal resources, or to borrow using short-term loans instead, reducing net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

4.5 Whilst this strategy is likely to be beneficial over the next two to three years, as official interest rates remain low, it is not sustainable in the medium-term. The markets are predicting a rise in long-term borrowing rates in the future. If we defer borrowing we will incur higher borrowing costs than if we borrowed now. We will regularly monitor the benefits of using internal borrowing now against the higher borrowing costs if we defer borrowing externally.

4.6 The Council's debt maturity profile as at 30th September 2014, showing the outstanding level of loans each year is attached as Appendix 7, and the long term borrowing serviced by the County Council analysed by maturity is shown in the graph below:



4.7 The Council has previously borrowed from the PWLB, but we will continue to investigate other sources of finance, such as local authority loans and bank loans, that may be available at rates that are more favourable. Any new borrowing taken out will be completed with regard to the limits, indicators, the economic environment, the cost of carrying this debt ahead of need, and interest rate forecasts set out above. The S151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

4.8 The other source of borrowing is the Lender Option Borrower Option (LOBO), which is a long-term borrowing deals structured in a such a way that a low rate of interest is usually offered for a short, initial period (anything from 1 year to 7 years), followed by a "step up" to a higher rate of interest (the "back end" interest rate), which is to be charged for the remainder of the loan period. The overall length of LOBOs is usually 40 or 60 years, but can be for shorter or longer periods.

4.9 The Council has £35.9m exposure to LOBO loans, of which £12.9m and £23.0m of these loans could be "called" during 2015/16 and 2016/17 respectively. A LOBO is called when the Lender (Banks) exercises its right to amend the interest rate on the loan at which point the Borrower (the Council) can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion.

Policy on Borrowing in Advance of Need

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

4.11 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the reporting mechanism.

Prudential & Treasury Indicators

4.12 There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

4.13 A full set of Prudential Indicators and borrowing limits are shown in Annex 2.

Debt Rescheduling

4.14 Officers continue to regularly review opportunities for debt rescheduling, but there has been a considerable widening of the difference between new borrowing and repayment rates, which has made PWLB debt restructuring now much less attractive. Consideration would have to be given to the large premiums (cash payments) which would be incurred by prematurely repaying existing PWLB loans. It is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings might still be achievable through using LOBO (Lenders Option Borrowers Option) loans, and other market loans, in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

4.15 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).

4.16 The strategy is to continue to seek opportunity to reduce the overall level of Council's debt where prudent to do so, thus providing in future years cost reduction in terms of lower debt repayments costs, and potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

4.17 All rescheduling will be agreed by the S151 Officer.

Sensitivity of the Forecast and Risk Analysis

4.18 Treasury management risks are identified in the Council's approved Treasury Management Practices, the main risks to the Council's treasury activities are:

- liquidity risk (inadequate cash resources);
- market or interest rate risk (fluctuations in interest rate levels and thereby in the value of investments);
- inflation risks (exposure to inflation);
- credit and counterparty risk (security of investments);
- refinancing risks (impact of debt maturing in future years); and
- legal and regulatory risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

4.19 Council officers, in conjunction with the treasury advisers, will monitor these risks closely. Particular focus will be applied to:

- the global economy – indicators and their impact on interest rates will be monitored closely. Investment and borrowing portfolios will be positioned according to changes in the global economic climate; and
- counterparty risk – the Council follows a robust credit worthiness methodology and continues to monitor counterparties and sovereign ratings closely particularly within the Eurozone.

5. Investment Strategy

5.1 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 Capita Asset Services al Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, and then return.

5.2 Investment instruments identified for use in the financial year are listed in section 5.15 and 5.18 under the 'Non-Specified and Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

Credit worthiness Policy

5.3 Officers regularly review the investment portfolio, counterparty risk and construction, and use market data, information on government support for banks and the credit ratings of that government support. Latest market information is arrived at by reading the financial press and through city contacts as well as access to the key brokers involved in the London money markets

5.4 This Council in addtion to other tools uses the creditworthiness service provided by Capita Asset Services. 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;
- Credit Default Swap spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.
-

5.5 The 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 credit worthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council will therefore use counterparties (Appendix 6) within the following durational bands provided they are domiciled in the UK or AAA countries only:

- Yellow 2 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

Y	*P*	*B*	*O*	*R*	*G*	*N/C*
Up to 2yrs	*Up to 2yrs*	*Up to 1yr*	*Up to 1yrs*	*Up to 6 mths*	*Up to 100days*	*No Colour*

5.6 The Capita Asset Services credit worthiness 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.

5.7 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

5.8 All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services credit worthiness service.

- if a downgrade results in the counterparty or 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 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.

5.9 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified investment sections; and
- It has sufficient liquidity in its investments.

5.10 The Capita Asset Services methodology was revised in October 2013 and determines the maximum investment duration under the credit rating criteria. Key features of Capita Asset Services credit rating policy are:

- a mathematical based scoring system is used taking ratings from all three credit rating agencies;
- negative and positive watches and outlooks used by the credit rating agencies form part of the input to determine a counterparty's time band (i.e. 3, 6, 9, 12 months etc.).
- CDS spreads are used in Capita Asset Services creditworthiness service as it is accepted that credit rating agencies lag market events and thus do not provide investors with the most instantaneous and "up to date" picture of the credit quality of a

particular institution. CDS spreads provide perceived market sentiment regarding the credit quality of an institution.

- After a score is generated from the inputs a maximum time limit (duration) is assigned and this is known as the Capita Asset Services colour which is associated with a maximum suggested time boundary.

5.11 The Capita Asset Services colours and the maximum time periods are shown para 5.5 above. In the Capita Asset Services methodology if counterparty has no colour then they are not recommended for investment and this would remove these counterparties from the Council's counterparty list.

Country Limits

5.12 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch Ratings (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Annex 4.

5.13 The exception will be the UK. The UK continues to enjoy an AA+ sovereign rating. However 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.

Specified Investments

5.14 An investment is a specified investment if all of the following apply:

- the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
- the investment is not a long term investment (i.e. up to 1 year);
- the making of the investment is not defined as capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended];
- the investment is made with a body or in an investment scheme of high credit quality (see below) or with one of the following public-sector bodies:
  - o The United Kingdom Government;
  - o A local authority in England or Wales (as defined under section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland; and
  - o High credit quality is defined as a minimum credit rating as outlined in section 5.15 of this strategy.

5.15 **The use of Specified Investments -** Investment instruments identified for use in the financial year are as follows:

- Table 3 below set out the types of investments that fall into each category, counterparties available to the Council, and the limits placed on each of these. A detailed list of each investment type is available in the Treasury Management Practices guidance notes;
- all investments will be within the UK or AAA sovereign rated countries.
- The Council's investments in Lloyds Banking Group were based on the fact that this group is part-nationalised by UK Government, and any changes to their credit ratings will impact on the duration of the Council investment with the Group.

5.16 Criteria for Specified Investments:

Table 3

Counterparty	Country/Domicile	Instrument	Maximum investments	Max. maturity period
Debt Management and Depost Facilities (DMADF)	UK	Term Deposits	unlimited	1 yr
Government Treasury blls	UK	Term Deposits	unlimited	1 yr
Local Authorities	UK	Term Deposits	unlimited	1 yr
RBS/NatWest Group • Royal Bank of Scotland • NatWest	UK	Term Deposits (including callable deposits), Certificate of Deposits	£60m	1 yr
Lloyds Banking Group • Lloyds Bank • Bank of Scotland	UK		£60m	1 yr
Barclays	UK		£60m	1 yr
Santander UK	UK		£60m	1 yr
HSBC	UK			
Goldman Sachs Investment Bank	UK		£60m	1 yr
Individual Money Market Funds	UK/Ireland/ domiciled	AAA rated Money Market Funds	£60m	Liquidity/instant access
Counterparties in select countries (non-UK) with a Sovereign Rating of at least AAA				
Australia & New Zealand Banking Group	Australia	Term Deposits/Call Accounts	£60m	1 yr
Commonwealth Bank of Australia	Australia	Term Deposits/Call Accounts	£60m	1 yr
National Australia Bank	Australia	Term Deposits/Call Accounts	£60m	1 yr
Westpac Banking Corporation	Australia	Term Deposits/Call Accounts	£60m	1 yr
Royal Bank of Canada	Canada	Term Deposits/Call Accounts	£60m	1 yr
Toronto Dominion	Canada	Term Deposits/Call Accounts	£60m	1 yr
Development Bank of Singapore	Singapore	Term Deposits/Call Accounts	£60m	1 yr
Overseas Chinese Banking Corp	Singapore	Term Deposits/Call Accounts	£60m	1 yr
United Overseas Bank	Singapore	Term Deposits/Call Accounts	£60m	1 yr

Counterparty	Country/Domicile	Instrument	Maximum investments	Max. maturity period
Svenska Handelsbanken	Sweden	Term Deposits/Call Accounts	£60m	1 yr
Nordea Bank AB	Sweden	Term Deposits/Call Accounts	£60m	1 yr

Non Specified Investments

5.17 Non-Specified investments are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out in Table 4 below. Non specified investments would include any sterling investments.

5.18 Criteria for Non Specified Investments:

Table 4

Non-Specified Investment	Minimum credit criteria	Maximum investments	Max. maturity period
UK Local Authorities	Government Backed	£60m	5 years

5.19 **Lending to third parties**

- The Council has the power to lend monies to third parties subject to a number of criteria. Any loans to or investments in third parties will be made under the Well Being powers of the Council conferred by section 2 of the Local Government Act 2000 or permitted under any other act including Localism Act 2011.
- The Well Being power can be exercised for the benefit of some or all of the residents or visitors to a local authority's area. The power may also be used to benefit organisations and even an individual.
- Loans of this nature will be under exceptional circumstances and must be approved by Cabinet.
- The primary aims of the Investment Strategy, in order of priority, are the security of its capital, liquidity of its capital and to obtain a return on its capital commensurate with levels of security and liquidity. These aims are crucial in determining whether to proceed with a potential loan.
- Recipients of this type of investment are unlikely to be a financial institution and therefore unlikely to be subject to a credit rating as outlined in section 2. In order to ensure security of the Authority's capital, extensive financial due diligence must be completed prior to any loan or investment being agreed. The Authority will use specialist advisors to complete financial checks to ascertain the creditworthiness of the third party. Where deemed necessary additional guarantees will be sought. This will be via security against assets and/or through guarantees from a parent company.

Investment Position and Use of Council's Resources

5.20 Investment returns expectations**.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2015/16 0.75%
- 2016/17 1.25%
- 2017/18 2.00%

5.21 There are upside risks to these forecasts (i.e. start of increases in Bank Rate occuring sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if

Bank of England forecasts for the rate of fall of unemployment were to prove to be too optimistic.

5.22 The Capita Asset Services suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

- 2015/16 0.60%
- 2016/17 1.25%
- 2017/18 1.75%
- 2018/19 2.25%

5.23 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

5.24 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).

5.25 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to100 days) in order to benefit from the compounding of interest.

Banking Services

5.26 NatWest, which is part Government owned, currently provides banking services for the Council.

6. Minimum Revenue Provision

6.1 The Council is required to repay 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).

6.2 CLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the MRP Policy in Annex 3.

6.3 The Council, in conjunction with its Treasury Management advisors, has considered the MRP policy to be prudent.

7. Policy on the use of External Service Providers

7.1 The Council uses Capita Asset Services as its external treasury management advisors.

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

7.3 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.

8. List of Annexes

Annex 1: Treasury Management Scheme of Delegation
Annex 2: The Prudential & Treasury Indicators
Annex 3: Minimum Revenue Provision (MRP) Policy Investment Strategy
Annex 4: Approved countries for investments
Annex 5: Comment from Capital Asset Services (our Treasury advisors) on the Economic Background and Forward View
Annex 6: Counterparty list
Annex 7: ESCC Debt Maturity Profile as at 30th September 2014.

ANNEX 1

Treasury Management Scheme of Delegation

1. Full Council

1.1 In line with best practice, full Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are:

a) Prudential and Treasury Indicators and Treasury Strategy (This report)
The first and most important report covers:
- the capital plans (including prudential indicators);
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

b) A Mid Year Treasury Management Report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and indicating whether the treasury strategy is meeting the strategy or whether any policies require revision.

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

2. Cabinet
- Approval of the Treasury Management quarterly update reports
- Approval of the Treasury Management outturn report.

3. Audit, Best Value and Community Services Scrutiny Committee
- Scrutiny of performance against the strategy.

4. The Treasury Management Role of the Section 151 Officer

4.1 The Section 151 (responsible) Officer:
- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit; and
- recommending the appointment of external service providers.

5. **Training -** Treasury Management training for committee members will be delivered as required to facilitate more informed decision making and challenge processes.

1. The Prudential and Treasury Indicators

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

1.2 **Capital Expenditure**. This prudential Indicator shows the Council's capital expenditure plans; both those agreed previously, and those forming part of this budget cycle. Capital expenditure excludes spend on PFI and leasing arrangements, which are now shown on the balance sheet.

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

Table 5

Description	2014/15 Projected	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
	£m	£m	£m	£m
Capital Expenditure	127.4	112.8	48.0	50.0
Financed by:				
Capital Reserves	18.1	17.8	1.8	0.1
Section 106		2.8		
Non Specific Grants	50.7	43.1	25.2	22.8
Capital Receipts	7.5	3.1		
Revenue Contributions	23.1	16.2	6.6	5.3
Net financing need for the year	**28.0**	**29.8**	**14.4**	**21.8**

1.4 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 paid for 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.

1.5 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.

1.6 Following accounting changes, the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases, landfill) brought on the balance sheet. 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 current Council CFR below include £96m of these liabilities.

Table 6

	2014/15 Projected	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
Capital Financing Requirement					
	£m	**£m**	**£m**	**£m**	**£m**
CFR	291	309	310	319	307
CFR – PFI/Leases	100	96	92	89	86
Total CFR	**391**	**405**	**402**	**408**	**393**
Movement in CFR	**18**	**14**	**(2)**	**6**	**(15)**

Movement in CFR represented by					
Net financing need for the year (above)	**34**	**30**	**14**	**22**	**-**
Less MRP/VRP	**(12)**	**(12)**	**(12)**	**(12)**	**(12)**
Less MRP - PFI/Leases	**(4)**	**(4)**	**(4)**	**(4)**	**(3)**
Movement in CFR	**18**	**14**	**(2)**	**6**	**(15)**

1.7 **The Operational Boundary.** This is the limit beyond which external borrowing 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 borrowing.

Table 7

Description	2014/15 Projected	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	£m	£m	£m	£m
Borrowing	303	319	320	329	318
PFI/Leases	98	96	92	89	85
Total	**401**	**415**	**412**	**418**	**403**

Operational boundary is a monitoring indicator that shows the most likely (prudent), but not worst case scenario for external debt. It directly links to the Council's capital expenditure plans, the CFR and cash flow requirements. It is a key management tool for in-year monitoring. Other long-term liabilities include finance leases, private finance initiatives and other liabilities that are not borrowing but form part of the Council's debt.
It represents the current debt portfolio and a maximum amount of temporary borrowing that may be required in the year. It is not a limit of total borrowing for the Council. It is calculated by taking the estimated CFR plus an allowance of headroom for cash movements.

1.8 **The Authorised Limit for external borrowing**. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.
The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003, and is the maximum amount of debt that the Council can legally owe.

The Council is asked to approve the following Authorised Limit:
Table 8

Description	2014/15 Projected	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	£m	£m	£m	£m
Borrowing	323	339	340	349	338
PFI/Leases	98	96	92	89	85
Total	**421**	**435**	**432**	**438**	**423**

The authorised limit provides headroom over and above the operational boundary for an unusual cash movement. We are required to set a limit for other long term liabilities, for example PFI/finance leases. Officers monitor the authorised limit regularly against all external debt items on the balance sheet (long and short-term borrowing, overdrawn bank balances and long-term liabilities).

2. Treasury Management Limits on Activity

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

Table 9

	2015/16	**2016/17**	**2017/18**
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	15%	15%	15%
Maturity structure of fixed interest rate borrowing 2014/15			
		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%	80%
10 years to 20 years		0%	80%
20 years to 30 years		0%	80%
30 years to 40 years		0%	80%
40 years to 50 years		0%	80%

2.2 **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:

2.3 **Actual and estimates of the 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. The estimates of financing costs include current commitments and the proposals in this budget report. The estimate below assumes no external borrowing projection.

Table 10

Description	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
	%	%	%
Ratio of Financing Cost to Net Revenue Stream	6.51	6.48	6.09

2.4 **Estimates of the incremental impact of capital investment decisions on council tax**. This indicator identifies the revenue costs associated with proposed changes to the four 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 four year period.

2.5 **Incremental impact of capital investment decisions on the band D council tax**
This indicator shows the incremental impact on the Band D council tax payer of the additional capital expenditure funded from borrowing included in the 2015-16 capital programme, and the estimate below assume no external borrowing projection.

Table 11

Description	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
	£	£	£
Council tax – Band D	0.00	0.00	0.00

3. Treasury Management Budget

Table 12

Description	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£m	**£m**	**£m**	**£m**	**£m**
Interest Payable	19.68	19.62	19.38	20.19	20.98
Investment Return	-2.25	-2.41	-2.58	-2.76	-2.95
Minimum Revenue Provision	12.39	12.39	13.02	12.38	11.79
*Debt Mgt Expenses/Internal Interest Payable	0.96	0.96	0.75	0.75	0.75
Treasury Management Budget	**30.79**	**30.57**	**30.57**	**30.57**	**30.57**

3.1 Assumptions behind the 2015/16 Budget:

- Capita Asset Services suggested rates of return on investments are as follow –
-

Table 13

	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	%	**%**	**%**	**%**	**%**
Investment Return - Rate	0.50	0.60	1.25	1.75	2.25

- the MRP charge is in line with the Council's MRP policy;
- Investment return is based on £350m average investment,
- Investment return is based on an annual average rate of 0.70% and
- *Debt Management Expenses/Internal Interest Payable includes bank charges, consultant fees, broker fees, projected interest payable on schools, and waste reserve, balances, etc.

Minimum Revenue Provision Policy Statement

1. Policy Statement

1.1 The statutory requirement for local authorities to charge the Revenue Account each year with a specific sum for debt repayment. A variety of options is provided to councils to determine for the financial year an amount of minimum revenue provision (MRP) that it considers to be prudent. This replaces the previous requirement that the minimum sum should be 4% of the Council's Capital Financing Requirement (CFR).

1.2 A Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start the financial year to which the provision relate. The Council is therefore legally obliged to have regard to CLG MRP guidance in the same way as applies to other statutory guidance such as the CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG guidance on Investments.

1.3 The MRP guidance offers four options under which MRP might be made, with an overriding recommendation that the County Council should make prudent provision to redeem its debt liability over a period which is commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. estimated useful life of the asset being financed).

1.4 The guidance also requires an annual review of MRP policy being undertaken and it is appropriate that this is done as part of this Annual Treasury Management Strategy.

1.5 The International Financial Reporting Standards (IFRS) involves Private Finance Initiative (PFI) contracts and some leases (being reclassified as finance leases instead of operating leases) coming onto the County Council Balance Sheets as long term liabilities. This accounting treatment impacts on the Capital Financing Requirement with an annual MRP provision being required.

1.6 To ensure that this change has no overall financial impact on Local Authorities, the Government has updated their "Statutory MRP Guidance" which allows MRP to be equivalent to the existing lease rental payments and "capital repayment element" of annual payments to PFI Operators. The implications of these changes are now being reflected in the Council's MRP policy for 2015/16.

1.7 The policy recommended for adoption from 1 April 2015 retains the key elements of the policy previously approved including provisions re PFI, closed landfill, and finance leases. The policy for 2015/16 is therefore as follows:-

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

- Based on based on the non-housing CFR, i.e., The Council currently set aside a Minimum Repayment Provision based on basic MRP of 4% each year to pay for past capital expenditure and to reduce its CFR.

1.9 From 1 April 2008 for all unsupported borrowing the MRP policy will be:

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

- Asset Life Method (annuity method) The Council will also be adopting the annuity method, - MRP calculated according to the flow of benefits from the asset, and where the principal repayments increase over the life of the asset. The policy is being adopted as a result of any PFI's, closed landfill, and finance lease assets coming on the balance sheet and any related MRP will be equivalent to the "capital repayment element” of the annual service charge payable to the PFI Operator and for finance leases, MRP will also be equivalent to the “capital repayment (principal) element” of the annual rental payable under the lease agreement.

Under both methods, the Council has the option to charge more than the statutory MRP each year through a Voluntary Revenue Provision (VRP).

1.10 In view of the variety of different types of capital expenditure incurred by the County Council, which is not in all cases capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure.

1.11 This approach also allows the Council to defer the introduction of an MRP charge for new capital projects/land purchases until the year after the new asset becomes operational rather than in the year borrowing is required to finance the capital spending. This approach is beneficial for projects that take more than one year to complete and is therefore included as part of the MRP policy. Half-yearly review of the Council’s MRP Policy will be undertaken and reported to Members as part of the Half-yearly Treasury Management Strategy review.

ANNEX 4

Illustrative list of Approved Countries for Investments

The list below shows the countries that would currently meet these criteria:

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- U.K.

Note: There are other three countries with AA+, but the Council will only be using UK because we have the best understanding of the UK market.

ANNEX 5

Capital Assets Services (our Treasury advisors) on the Economic Background and Forward View

1. The Global Economy

1.1 **The Eurozone**. 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.

1.2 **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.

1.3 **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.

1.4 **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.

2. The UK Economy

2.1 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.

2.2 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.

2.3 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.

2.4 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.

3. Capita Asset Services forward view

3.1 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.

3.2 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

3.3 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.

3.4 The interest rate 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.

3.5 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.

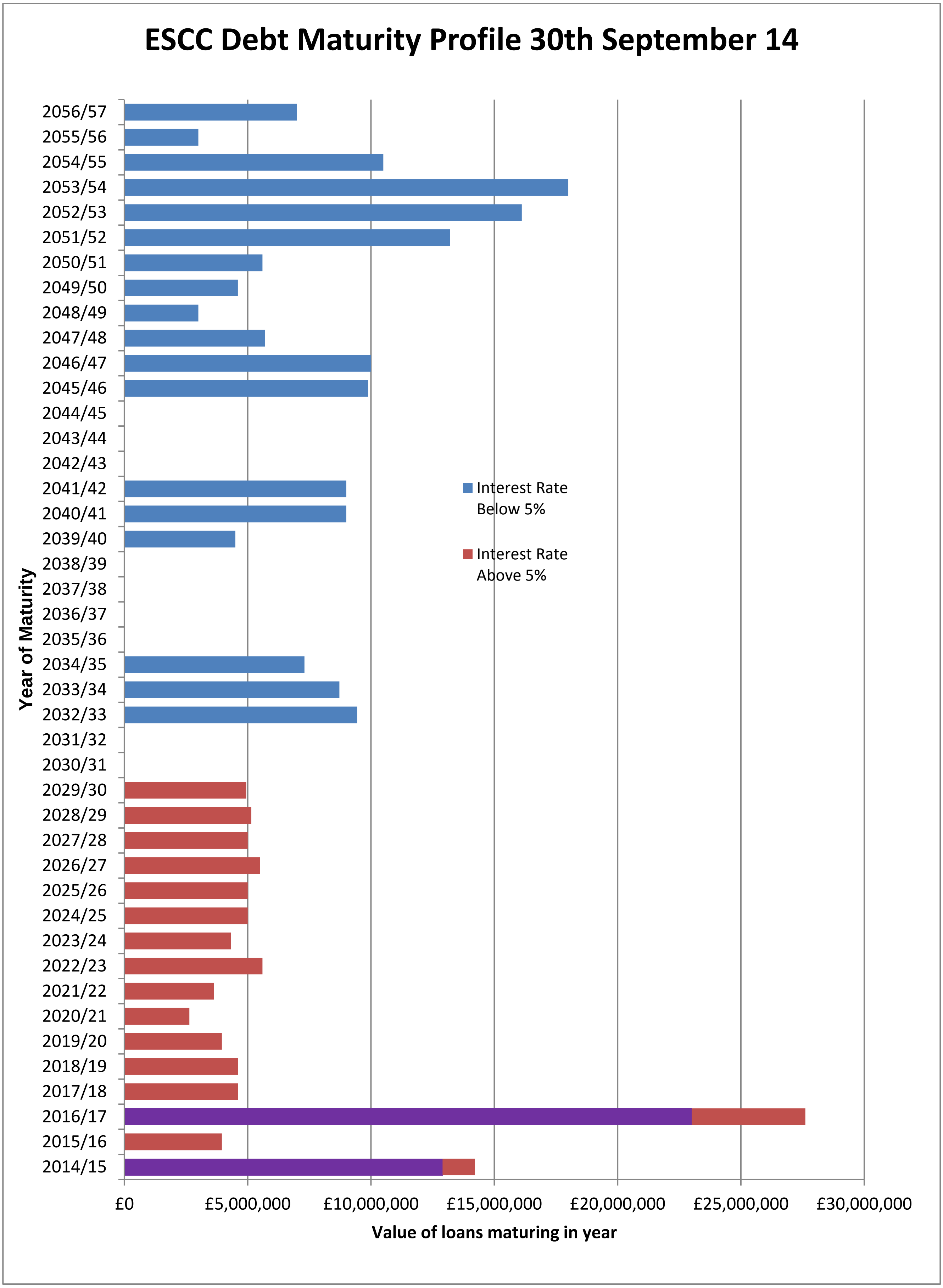
- Recapitalisation of European banks requiring considerable government financial support.
- Lack of support by populaces in Eurozone countries for austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic 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.
-

3.6 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.

Annex 6 - New Counterparty list Bank with duration colour	Country	Fitch Ratings				Moody's Ratings			S & P Ratings		CDS Price	ESCC Duration	Capita Duration Limit	Money Limit
		L Term	S Term	Viab.	Supp.	L Term	S Term	FSR	L Term	S Term		(Months)	(Months)	(£m)
Australia & New Zealand Banking Group	Australia	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	56.1	12	12	60
Commonwealth Bank of Australia	Australia	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	57.5	12	12	60
National Australia Bank	Australia	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	57.5	12	12	60
Westpac Banking Corporation	Australia	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	57.5	12	12	60
Royal Bank of Canada	Canada	AA	F1+	aa	1	Aa3	P-1	C+	AA-	A-1+	-	12	12	60
Toronto Dominion	Canada	AA-	F1+	aa-	1	Aa1	P-1	B	AA-	A-1+	-	12	12	60
Development Bank of Singapore	Singapore	AA-	F1+	aa-	1	Aa1	P-1	B	AA-	A-1+	-	12	24	60
Oversea Chinese Banking Corp	Singapore	AA-	F1+	aa-	1	Aa1	P-1	B	AA-	A-1+	-	12	24	60
United Overseas Bank	Singapore	AA-	F1+	aa-	1	Aa1	P-1	B	AA-	A-1+	-	12	24	60
Svenska Handelsbanken	Sweden	AA-	F1+	aa-	1	Aa3	P-1	C	AA-	A-1+	-	12	12	60
Bank	Country	Fitch Ratings				Moody's Ratings			S & P Ratings		CDS Price	ESCC Duration	Capita Duration Limit	Money Limit
		L Term	S Term	Viab.	Supp.	L Term	S Term	FSR	L Term	S Term		(Months)	(Months)	(£m)
Nordea Bank AB	Sweden	AA-	F1+	aa-	1	Aa3	P-1	C	AA-	A-1+	-	12	12	60
Lloyds Banking Group:														60
Lloyds Bank Plc	UK	A	F1	a-	1	A1	P-1	C-	A	A-1	-	12	12	
Bank of Scotland	UK	A	F1	a-	1	A1	P-1	C-	A	A-1	-	12	12	
RBS/NatWest Group:														60
NatWest Bank	UK	A	F1	bbb	1	Baa1	P-2	D+	A-	A-2	-	12	12	
Royal Bank of Scotland	UK	A	F1	bbb	1	Baa1	P-2	D+	A-	A-2	53.5	12	12	
HSBC Bank	UK	AA-	F1+	a+	1	Aa3	P-1	C	AA-	A-1+	-	12	12	60
Barclays Bank	UK	A	F1	a	1	A2	P-1	C-	A	A-1	49.0	6	6	60
Santander UK plc (not Spanish Santander)	UK	A	F1	a	1	A2	P-1	C-	A	A-1	-	6	6	60
Goldman Sachs IB	UK	A	F1	-	-	A2	P-1	D+	A	A-1	-	6	6	60

Annex 7



ESCC Debt Maturity Profile 30th September 14
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2055/56
2054/55
2053/54
2052/53
2051/52
2050/51
2049/50
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2020/21
2019/20
2018/19
2017/18
2016/17
2015/16
2014/15
Year of Maturity
Interest Rate Below 5%
Interest Rate Above 5%
£0
£5,000,000
£10,000,000
£15,000,000
£20,000,000
£25,000,000
£30,000,000
Value of loans maturing in year