Reigate & Banstead
BOROUGH COUNCIL
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REPORT OF:	FINANCE MANAGER
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TO:	OVERVIEW AND SCRUTINY COMMITTEE
DATE:	5 MARCH 2014

WARD (S) AFFECTED:	ALL

SUBJECT:	**DRAFT TREASURY MANAGEMENT STRATEGY 2014/15**

RECOMMENDATIONS:

The Committee is requested to consider the draft Treasury Management Strategy published by the Executive on 30 January 2014 and to offer any comments to the Executive on this report.

SUMMARY:

This report provides the Committee with the report published by the Executive on the draft Treasury Management Strategy for 2014/15 for consultation. The Committee is requested to consider this report and to submit any comments to the Executive on the draft Strategy.

The Committee is also requested to consider the comments made at the Treasury Management Portfolio Panel meeting held on 19 February 2014 that considered the draft Strategy.

STATUTORY POWERS

1. The Local Government Act 2000 introduced the requirement for Overview and Scrutiny Committees. The Council's Constitution provides arrangements for the Committee to consider Policy Framework documents.

DRAFT TREASURY MANAGEMENT STRATEGY 2014/15

2. The Executive on 30 January 2014 published the attached draft Treasury Management Strategy 2014/15 (**Annex 1**) for consultation.

3. The Committee is requested to consider the draft Strategy and to provide comments to the Executive at their meeting on 20 March 2014.

4. To assist the Committee in this consultation the draft Strategy has been considered by the Treasury Management Portfolio Panel on 19 February 2014. The Panel considered the following matters at their meeting :

    - An analysis of current economic trends including economic growth; Bank of England forecast; inflation; unemployment levels and consumer confidence; UK Government finances; UK quantitative easing and money supply;

projections on interest rates; current investment list and analysis; and external investment yields.

- Increasing the length of deposits to 3 years to maximise investment interest. Discussions recognised the need to focus on counterparty security and agreed that deposits for longer than one year should only be made with other local authorities.
- Potentially extending the Investment Property portfolio as an alternative approach to income generation where significant returns can be made. The use of borrowing could be considered if it was appropriate to the circumstance. The potential impact on the capital financing requirement prudential indicator if any borrowing was undertaken.

5. The Panel proposed the following amendment to the Strategy:
   - Increasing the time limit for investments with local authorities only for a maximum of 3 years. This extended time limit would be for £5m per counterparty and £10m or 20% of the investment portfolio in total. These were recognised as safe investments with a potential uplift in rate of return.
6. In conclusion, having considered the above issues the Members of the Portfolio Panel supported the proposals within the review of the Treasury Management Strategy.

Background Papers: Executive Agenda: 30 January 2014

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REPORT OF:	CHIEF FINANCE OFFICER
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TO:	EXECUTIVE
DATE:	30 JANUARY 2014
EXECUTIVE MEMBER:	COUNCILLOR V.W. BROAD

KEY DECISION REQUIRED:	YES
WARD(S) AFFECTED:	ALL

SUBJECT:	**DRAFT TREASURY MANAGEMENT STRATEGY**

RECOMMENDATION:

The Executive approve the contents of this report and annexes for formal consultation in accordance with the Council's Constitution.

EXECUTIVE SUMMARY:

To comply with the Code of Practice on Treasury Management the Council has to approve annually prudential indicators and a Treasury Management Strategy that reflects the Council's expected operations in this area for the 2014/15 financial year.

The above recommendation can be determined by the Executive.

STATUTORY POWERS

1. The Council operates its Treasury Management activity as an integral part of its statutory obligation to effectively manage the Council's finances under the *Local Government Act 2003* and associated regulations.
2. The Council's Treasury Management activities are undertaken in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management and the Prudential Code for Capital Finance in Local Authorities, and the Government's Investment Regulations.

ISSUES

3. The Council is required to approve an annual Treasury Management Strategy and Prudential Indicators so that borrowing and investments are prudent, affordable and sustainable.
4. The objective of this report is to seek approval for the 2014/15 Treasury Management Strategy. The Strategy consists of three separate statements that have been compiled in accordance with the Council's Treasury Management Policy Statement. Namely:

- The Investment Strategy (Annex 1)
- The Borrowing Strategy (Annex 2)
- The Cash Management Strategy (Annex 3)

5. Each strategy will contain the appropriate Prudential Indicators relevant to that area. In addition, the Treasury Risk Management Assessment has been incorporated in the report as Annex 4.

6. Included in Annex 5 is an economic update provided by our Treasury Management advisors to support this strategy.

Objectives

7. To accord with the Council's Treasury Management Policy Statement, the Treasury Management Strategy has the following objectives:

   - To consider and effectively address the risks associated with Treasury Management activity.
   - To optimise the flow of cash through the organisation in order to maximise the potential for using it to earn investment income for the Council.
   - To optimise the returns from investments whilst meeting the overriding need to protect the capital sum and ensure that the cash is available when the Council requires it.
   - To stabilise investment returns.
   - To align investments in relation to cash flow, within statutory constraints, in order to increase investment returns in future years.
   - To optimise the revenue costs of undertaking all treasury activities.
   - To monitor and review significant changes in the pattern of cash movements and interest rate movements and react accordingly.

The Current Treasury Position

8. The following table shows the Council's net investment position at 31st December 2013 and the projected position for March 2014. The table also splits both the borrowings and investments between fixed or variable interest rates.

9. The table excludes all money currently invested with the Icelandic banks. When any of this is received back balances shown in the table will rise.

	Actual as at 31/3/13 £'000	Average Earnings/Paid Rate %	Current Position as at 31/12/13 £'000	Estimated Position as at 31/3/14 £'000	Anticipated Average Earnings/Paid Rate %
Fixed Rate Borrowings	0	0.00	0	0.00	0.00
Variable Rate Borrowings	0	0.00	0	0.00	0.00
TOTAL BORROWINGS	0	0.00	0	0.00	0.00
Fixed Investments					
Externally managed	43,000	2.15	43,000	43,000	1.20
In house	5,000	1.00	15,000	5,000	1.00
Variable Investments	0		0	0	
TOTAL INVESTMENTS	48,000	2.03	58,000	48,000	1.18
Net Investments	**48,000**		**58,000**	**48,000**	

[1] The differences between the positions at 31st December and 31st March are due to normal changes arising from the Council's day-to-day cash flow requirements.

10. The current economic environment continues to remain challenging for the Council with interest rates on short term investments declining even further during 2013/14. However, the returns for medium to long-term investments have shown improvement over the past financial year, especially in the local government market.

Matters for consideration

11. Counterparty security remains the Council's over-arching investment objective and the criterion for selection of these institutions is not proposed to be changed. However, as set out in paragraph 10 above, the returns for medium-term (3-5 years) investments have increased and it is proposed that where favourable rates are offered for these deposits by high quality UK banks and/or local authorities meeting the criterion set out in the Investment Strategy, such deposits are made. Although this is not a change to the Investment Strategy itself, which has always permitted such deposits, operationally only investments under 365 days have been made.

12. In order to facilitate these investments, it is also proposed that internally managed funds can be invested for a maximum of 3 years; a change from the current limitation of 365 days.

13. The Council is also considering alternative approaches to income generation through use of its assets that can be used to support delivery of services. One possible approach being developed is to extend the Council's investment property portfolio. As at 31/3/13 the Council had nearly £14 million of investment properties generating an income of over £880,000 – a significant return on its assets. The funding of potential purchases may differ depending upon the expected rate of return but may include borrowing or self-financing – which would see a reduction in the level of deposits.

Prudential Indicators

14. The statutory Prudential Indicators contained within the Treasury Management Strategy are considered a sound basis for the future and authority will be sought to adopt them. A summary of the key indicators that impact upon the Council are set out in the following table. All of the prudential indicators are set out and explained in the Investment and Borrowing Strategies.

Summary of 2014/15 'Key' Prudential Indicators

	2013/14 Projected £'000	2014/15 Budget £'000	2015/16 Forecast £'000	2016/17 Forecast £'000	2017/18 Forecast £'000
Capital Expenditure	6,907	18,630	6,118	1,925	1,388
Capital Financing Requirement	0	0	0	0	0
Authorised Limit for External Debt	25,000	25,000	25,000	25,000	25,000
Operational Boundary for External Debt	15,000	15,000	15,000	15,000	15,000
Upper limits on variable rate exposure	25%	25%	25%	25%	25%
Upper limits on fixed rate exposure	100%	100%	100%	100%	100%

OPTIONS

15. There are 3 options:

16. Option 1 - To not support the contents of this report

This would leave the Council not being compliant with the Code of Practice, which will result in criticism from our External Auditor, KPMG.

It would also means that Officers will not have a mandate under which to undertake treasury management activities, which will lead to the Council only receiving minimal returns on its investments.

17. Option 2 - To defer the report and ask Officers to provide more information/clarification on any specific points

The current Investment Regulations issued by the Department of Communities and Local Government means that this strategy should be approved prior to the financial year to which it relates.

Any delay in approving the Strategy could leave the Council open to the same risks identified in option 1 above.

18. Option 3 – Approve the recommendations within this report

This would provide the best opportunity to minimise the risk of audit criticism and to maximise the potential returns that can be earned during the coming financial year.

Officers recommend that the Executive should consider supporting option 3.

LEGAL IMPLICATIONS

19. There are no direct legal implications arsing from this report.

FINANCIAL IMPLICATIONS

20. The financial impacts of this proposed strategy have already been reflected within the Council's 2014/15 Budget proposals. There are no additional direct financial implications that arise from this report.

EQUALITIES IMPLICATIONS

21. There are no equality issues that need to be considered as part of this report.

RISK MANAGEMENT CONSIDERATION

22. These are detailed in Annex 4 (Risk Management Assessment).

OTHER IMPLICATIONS

23. There are no other implications arising from this report.

CONSULTATION

24. It will be reviewed by a Member Panel led by the Portfolio Holder for Finance and by the Overview & Scrutiny Committee.
25. It will then return to the Executive in its final form for consideration in March.

POLICY FRAMEWORK

26. The Strategy is part of the Council's Policy Framework as set out in Article 4 of the Constitution.

Background documents: Treasury Management Strategy Report to the Executive March 2013

ANNEX 1

REIGATE & BANSTEAD BOROUGH COUNCIL

INVESTMENT STRATEGY

2014 / 2015

BACKGROUND

1. This strategy is made in accordance with the DCLG Guidance on Local Government Investments and the CIPFA Treasury Management Code of Practice.

2. This strategy applies to both in-house and externally managed funds. The external managers must confirm with the Council the acceptability of a counterparty before an investment is made.

INVESTMENT OBJECTIVES

3. The Council's investment strategy primary objections are as follows:
    i. Security – safeguarding the repayment of the principal sum invested
    ii. Liquidity – funds are available when needed
    iii. Yield – return on the investment (but only considered once the first two objectives are satisfied)

PRUDENTIAL INDICATORS

4. There are three indicators that apply to investments. The purpose of these indicators is to contain the activity of the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates impacting negatively upon the Council's overall financial position. However, if these are set up to be too restrictive they will impair the opportunities to optimise returns. The indicators are:

    a. Upper limits on variable interest rate exposure – this identified a maximum limit for variable interest rates based upon the debt position net of investments (see Table 1 below)(this is investing deposits in structured or stepped arrangements).
    b. Upper limits on fixed interest rate exposure (see Table 1 below) (this means investing deposits in fixed-term arrangements).
    c. Total principal funds invested for greater than 364 days – these limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment.

Table 1: Limits on variable and fixed interest rate exposure

Indicator	**2014/15**	**2015/16**	**2016/17**
Upper limits on variable rate exposure	25%	25%	25%
Upper limits on fixed rate exposure	100%	100%	100%

5. For liquidity planning processes the Council aligns the duration of its investments with the Council's anticipated spending requirements, up to a maximum of five years. This therefore sets the percentage of the investment portfolio that will be invested for more than 364 days.

6. The following table compare the Council's current overall cash flow requirement, which is a combination of its capital expenditure programme and revenue cash flow. This sets out the percentages that are then used to set the financial limits for investments in each time period. This sets the maximum limit as to how much can be invested for a period greater than 364 days.

Table 2: Analysis of investments

		<1 year	**1-2 years**	**2-3 years**	**3-4 years**	**4-5 years**	**Total**
Planned Expenditure programme	£000	6,907	18,630	6,118	1,925	1,388	34,968
	%	20	53	17	6	4	100
Planned Investment programme	£000	9,600	25,440	8,160	2,880	1,920	48,000
	%	20	53	17	6	4	100
Current Investment Position as at 31/12/2013	£000	58,000	0	0	0	0	58,000
	%	100	0	0	0	0	100

OTHER PERFORMANACE INDICATORS

7. The Code of Practice on Treasury Management requires the Council to set Performance Indicators to assess the adequacy of the treasury function over the year. The Performance Indicators relevant to this Investment Strategy are set out in the following paragraphs.

(i) Internally managed funds

8. The in-house officer will focus their time on the overall management of the Council's cash flow and will limit their investments deals to durations that are under 3 years.

9. As the nature of these investments will be associated with the effective management of the cash flow, any investment opportunities will needs to be evaluated against the alternative cost of maintaining any short term borrowings that the Council may need.

(ii) Externally managed funds

10. The External Fund Managers will manage investment deals over the full range of durations from three months up to a maximum of 5 years. The current contracted target is for them to achieve returns that are in excess of the average 3 month LIBID rate.

11. The performance of the External Manager is reviewed quarterly. Officers and the Managers meet on a six monthly basis for a formal review of performance.

12. Overall treasury management performance is reviewed monthly and reported biannually in the Mid Year Treasury Performance and Treasury Management Outturn reports.

RISK MANAGEMENT

9. In terms of implementing the above investment objective the Council will need to consider it against the risk elements identified in Treasury Management Practice Statement (TMP) 1 – Risk Management.

10. A risk assessment showing how the risks will be managed in order to achieve the investment objective is set out on Appendix 1.

11. In accordance with the CIPFA Code of Practice on Treasury Management Appendix 2, sets out the framework that the Finance Manager (as the Council s151 officer) will ensure is used to make individual investment decisions.

Appendix 1

TREASURY MANAGEMENT PRACTICE NOTE 1 – RISK ASSESSMENT

RAG indicator:

Red (R) - This is a risk has a high potential to impact the Council and therefore should be actively being managed

Amber (A) - This is a risk which the Council needs to monitor, but is not viewed as having a high potential of impact on the Council

Green (G) - This is a risk that either does not apply to the Council, or is under sufficient control to be viewed as having a very low potential of impacting the Council

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
Credit & Counterparty	This is the key risk for the Council. The security of 'capital' investment is critical.	R	The Council uses Credit Ratings and other market intelligence to access the credit quality of any potential counterparty. The Council sets limits as to the minimum level of credit rating that it will accept for any individual counterparty. The current minimum levels are: Short-term (less then one year in duration) Fitch - F1 Standard & Poors - A-1 Moody's - P-1 Medium-term (greater than 1 year up to and including 3 years) Fitch A+ Standard & Poors A+ Moody's A1

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
			Longer-term (greater than one year in duration up to and including 5 years) Fitch - AA- Standard & Poors - AA- Moody's - Aa3 In addition all international banks we might want to invest in will need to be supported by guarantees from their national central banks and their national government will need to have their own sovereign rating of 'AAA'. The constitution of Money Market Funds means that they spread their investment over a wide range of counterparties and financial instruments which itself reduces the impact of this risk being realised. In addition these funds will be subject to either having UK Government guarantees or will have the following minimum credit rating. Fitch - AAA Standard & Poors- AAA Moody's - Aaa The Council sets a maximum exposure level, expressed in "£" that can be invested with any one organisation. The current limit is a maximum of £10m for some UK banks. UK Government securities or other Local

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
			authorities, parish or community councils form an exception, where exposure can be unlimited. To limit exposure in respect of Building Societies the Council will only invest with those societies with a minimum asset base of over £1 billion pounds.
Liquidity	This is second key risk for the Council. To provide services it needs to ensure that it has money available when required and that the provision of the money should be delivered in the most cost effective way.	A	The Council maintains both an operational (1 year) and strategic (up to 5 years) Cash flow model. Investment durations are then set to accord with when the money will be required according to the strategic cash flow model. ***Each transaction takes into account the underlying macro economic environment at the time the transaction is being considered.***
Interest Rate	This is a potential risk to the Council of investing in transactions that have a 'variable' interest rate that might change over the duration of the transaction.	A	All 'cash' deposit transactions are undertaken on a 'Fixed-term' or 'Structured/stepped' deal basis which determines the interest rate and duration at the time the transaction is entered into.
Exchange Rate	This is not a risk for this Council, as all financial investment transactions are undertaken in '£' sterling.	G	Not applicable
Refinancing	This is not a risk for the Council as it does not have 'long term' borrowing.	G	Not applicable.
Legal and Regulatory	This is a potential risk for the Council.	A	The Council's constitution and associated documentation (i.e. Financial Procedure Rules) clearly

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
			set out the governance framework within which Treasury Management activity is undertaken. The Council's Treasury Management Practice notes (TMP's) clearly set out roles and responsibilities and authorisation limits. In terms of the legal status of counterparties to deal with the Council, the Council relies upon advice from its Treasury Advisors (Sector) and the fact that legal status is part of the elements that go to make up the 'credit rating' issued by the Rating Agencies. The 'Credit Quality' checks undertaken on all potential counterparties include a check that they are legally able to transact financial arrangements with public sector organisations. This is also mitigated by limiting the Council's counterparty list.
Fraud, error & Corruption and contingency management	This is a potential risk for the Council.	A	The Council's Treasury Management Practice notes (TMP's) clearly set out roles and responsibility and authorisation limits. All treasury transactions require the involvement of ***at least three Officers, split across two separate work teams (Treasury Management and Cash Management). Each with the power to defer any transaction taking place.***

Risk	Council's view of Risk	RAG Indicator	Mitigation actions/controls included within the Treasury Management Strategy
			Internal audit undertake an annual independent audit on both the effectiveness of the Council's treasury management control arrangements and whether all the transactions that have been undertaken are compliant with the Treasury Management Policy, Treasury Management Strategy and the TMP's.
Market risk	This is a potential risk for the Council.	A	As all 'cash' deposit transactions are undertaken on a 'Fixed-term' or 'Structured/stepped' basis this removes the potential of this risk occurring. All 'Gilt' investments are bought and held to maturity, this again removes the potential for this risk. As you buy a share in the value of the MMF at the time of investment, any downward movement in the relative share price could open the Council to a potential capital loss, but the likelihood of this occurring is low given that these funds by their nature invest in a wide range of financial instruments and financial institutions and earn their commission from increases in the share price.

Appendix 2

Treasury Management Practice (TMP) 1 (1) – Credit and Counterparty Risk Management

1. The Office of the Deputy Prime Minister (now CLG) issued investment guidance initially on 12th March 2004, which was updated in 2010. These guidelines do not apply to either trust funds or pension funds, which are regulated by different regulatory regimes.

2. The key intention of the guidance is to maintain the requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication *Treasury Management in the Public Services: Code of Practice and Cross-Sector Guidance Notes*. This Council adopted the original Code on 31st March 2003 and has now adopted the revised Code on the 15th April 2010. The principles of the new code have been applied within the Council's Treasury Management Policy Statement. In accordance with the Code the Director of Resources has produced treasury management practice statements. This part, TMP 1(1), covering investment counterparty requires specific approval each year as part of the wider Treasury Management Strategy.

3. **Annual Investment Strategy -** The key requirement of both the Code and the investment guidance is to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

    i. The strategy guidelines for decision making on investments, particularly non-specified investments;

    ii. The principles to be used to determine the maximum periods for which funds can be committed;

    iii. Specified investments the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year. This will need to define broad categories of investment and the regularity of monitoring;

    iv. Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

4. This strategy is to be approved by full Council. Items (i) to (iv) are addressed further in the following paragraphs.

5. **Strategy Guidelines** – The main strategy guidelines are contained in the body of the Treasury Strategy – Investment Strategy statement.

6. **Specified Investments** – These investments are sterling investments of not more than 365 day duration, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These should be low risk assets where the possibility of loss of principal or investment income is negligible. These would include investments with:

	Specified Investment Category (up to 365 day duration)	**Limit (£ or %)**
a.	**Securities fully backed by the UK Government.** This includes Debt Management Office, UK Treasury Bills or Gilts with less than one year to maturity and held to maturity.[1]	Unlimited
b.	**Local authority, parish council or community council**	Unlimited
c.	**Sterling Money Market Fund.** These Funds are solely invested in UK government securities or those backed by UK government securities and fully guaranteed by the UK Government	£5m per Fund
d.	**Money Market Fund.** These Funds should invest in a range of sectors and institutions to spread the risk of counter-party default. Access to funds should be immediate or overnight. Investments will be in organisations that have the following minimum credit ratings with all three Credit Rating Agencies Fitch - AAA Moody's - Aaa Standard & Poor - AAA	£5m per Fund
e.	**Any UK Bank** that is regulated by the Prudential Regulation Authority **and** has a minimum Short Term credit rating of the following rating with all the three Credit Rating Agencies Fitch - F1 Moody's - P-1 Standard & Poor - A-1	Lower of £10m or 20% total investments with any individual counterparty
f.	**Any UK Building Society** that is regulated by the Building Societies Commission **and** has a minimum of a £1billion asset base.	Lower of £10m or 20% total investments with any individual counterparty

7. Overall a minimum of £5m or 20%, whichever is the greater, of the Council's total investment should be invested in some form of specified investments to cover normal day-to-day cash flow requirements and unforeseen emergencies.

[1] Gilts will always be held to maturity

8. **Non-Specified Investments** – Non-specified investments are any other type of investment (i.e. not categorised as Specified above) with an investment duration that is (in most cases) greater than 365 days. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any sterling investments with:

	Non Specified Investment Category	**Limit (£ or %)**
g.	**Securities fully backed by the UK Government.** This includes Debt Management Office, Nationalised Banks, UK Treasury Bills or Gilt-edged securities with a maturity of greater than one year and held to maturity[2]. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	Unlimited
h.	**Local authority, parish council or community council**	Unlimited
i.	**UK Building Societies**, regulated by the Prudential Regulation Authority. The operating activities of some building societies are such that they do not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies but only if they have a minimum asset size of £1 Billion**.**	£5m up to 3 years for an individual counterparty
j.	**Any UK Bank**, regulated by the Prudential Regulation Authority that has a minimum long-term credit rating from all three of the Credit Rating Agencies; for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment). Minimum ratings Fitch - AA Moody's - Aa3 Standard & Poor - AA-	£10m up to 5 years for an individual counterparty (or group)

[2] Gilts will always be held to maturity.

	Non Specified Investment Category	Limit (£ or %)
k.	**Any UK Bank, regulated by the Prudential Regulation Authority that has a minimum long-term credit rating from all three of the Credit Rating Agencies; for deposits greater than one year (including forward deals in excess of one year from inception to repayment)** **Minimum ratings** **Fitch A+** **Moody's A1** **Standard & Poors A+**	£5m up to 3 years for an individual counterparty (or group)
l.	**International Banks or Financial Institutions.** This will include organisations such as the World Bank, European Central Bank and other commercial banks/institutions where wholesale investments are fully guaranteed by the associated national government. These banks will have to possess as a minimum a following long term credit rating from all three of the Credit Rating Agencies Fitch - AA+ Moody's - Aa1 Standard & Poor's - AA+	£5m up to 3 years for an individual counterparty (or group)

9. **The Monitoring of Investment Counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating lists covering all three Credit Rating Agencies advice from its advisers, Sector, who issue daily updates as and when ratings change. These lists form the Council's counterparty list from which institutions are selected subject to them meeting the minimum criteria set in the above tables. On occasion ratings may be downgraded to below the minimum ratings or institutions are placed on negative credit watch. In either of these instances such institutions are not considered as acceptable counterparties for investment purposes.

REIGATE & BANSTEAD BOROUGH COUNCIL

BORROWING STRATEGY

2014/15

BACKGROUND

1. The *Local Government Act 2003* requires the Council to adopt the Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code and to produce "prudential indicators". Each indicator either summarises the expected capital and borrowing activity or introduces limits on that activity. The indicators are required to be approved by the Council as part of its annual review of Treasury Management activity.

2. The purpose of this Strategy is to set out the Council's position on the need to borrow money to fund its capital expenditure, or its cash flow, for the 2014/15 financial year.

PRUDENTIAL INDICATORS

Capital Expenditure Plans

3. The Council's capital expenditure plans are summarised in Table 1 and this forms the first of the prudential indicators. A certain level of capital expenditure may be grant supported by Government; any decisions taken to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure will need to have regard to:

    - Service objectives (e.g. strategic planning)
    - Stewardship of assets (asset management planning)
    - Value for money (e.g. options appraisal)
    - Prudence and sustainability (e.g. implications for external debt and whole life costing)
    - Affordability (e.g. implications for council tax)
    - Practicality (e.g. achievement of forward plan)

4. This expenditure can be paid for immediately (by resources such as capital receipts, capital grants etc.), but if these resources are insufficient any residual expenditure will create a borrowing need.

5. The key risks to the plans are that the level of Government support has been estimated and is therefore subject to change. Similarly some of the estimates for other sources of funding, such as capital receipts, may also be subject to change over time.

6. The Council is asked to approve the following capital expenditure programme as part of its budget for 2014/15.

Table 1: Capital Expenditure Programme

Capital Expenditure	2013/14 Revised £000	2014/15 Budget £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Forecast £000
Waste & Recycling Improvements	725.0	641.0	20.0	20.0	20.0
Environment	267.5	162.0	76.0	76.0	76.0
Capital Grants	921.8	680.0	680.0	680.0	680.0
Regeneration	1,029.3	7,258.5	3,406.2	301.0	0.0
Leisure & Culture	1,779.3	9,335.0	1,429.6	440.0	270.0
Strategic Property	18.4	0.0	0.0	0.0	0.0
Organisational Change	1,215.3	120.0	0.0	70.0	0.0
Rolling Programmes	949.9	433.3	506.0	338.0	342.0
Total Capital Programme	**6,906.5**	**18,629.8**	**6,117.8**	**1,925.0**	**1,388.0**

The funding for the programme is outlined in the table below.

Table 2: Capital Expenditure Programme Financing

Capital Expenditure	2013/14 Revised £000	2014/15 Budget £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Forecast £000
Total Expenditure (from Table 1)	6,906.5	18,629.8	6,117.8	1,925.0	1,388.0
Capital Reserves	6,082.0	11,884.9	3,373.9	1,319.6	983.6
Capital Grants and Contributions	824.5	6,744.9	2,743.9	605.4	404.4
Revenue	0	0	0	0	0
Total Financing	6,906.5	18,629.8	6,117.8	1,925.0	1,388.0
Net Financing Need*	0	0	0	0	0

*The Council's borrowing need (the change in capital financing requirement excluding sums set aside for redemption of debt).

Capital Financing Requirement

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

8. The Council is asked to approve the CFR projections below.

Table 3: Projected Capital Financing Requirement

	2013/14 Revised £000	2014/15 Budget £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Forecast £000
Capital Financing Requirement (brought forward)	0	0	0	0	0
Borrowing Requirement (from Table 2)	0	0	0	0	0
Minimum Revenue Provision	0	0	0	0	0
Capital Financing Requirement (carried forward)	**0**	**0**	**0**	**0**	**0**

9. The Council has no PFI or finance lease liabilities, if it were to enter into any of these schemes the accounting treatment would require the long term liability to be included in the CFR calculations.

10. The Council is required to pay off an element of the accumulated CFR year each through a revenue charge (the 'Minimum Revenue Provision (MRP)') although it is allowed to undertake additional, voluntary payments.

11. Although the Council does not have a CFR and so it is not required to undertake MRP, CLG Regulations require the Council to have full regard to their guidance which requires approval of an MRP Statement in advance of each year. The Council is recommended to approve the following MRP Statement.

MRP Statement

12. Regulation 28 of the 2003 regulations (as amended by regulation 4 of the 2008 regulations) requires a local authority to calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent. The Secretary of State recommends that, for the purposes of the regulations, the prudent amount of provision should be determined with the broad aim of ensuring that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits. In order to achieve this aim, the Council will determine the MRP for the year by what is termed an **Asset Life Method,** which is summarised below.

13. Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be made in equal annual instalments over the life of the asset, in accordance with the following formula:

$$\frac{\mathbf{A-B}}{\mathbf{C}}$$

Where:

A – is the amount of the capital expenditure in respect of the asset financed by borrowing or credit arrangements
B – is the total provision made before the current financial year in respect of that expenditure
C – is the inclusive number of financial years from the current year to that in which the estimated life of the asset expires.

Affordability Prudential Indicators

14. In order to consider the affordability of its capital plans, all resources currently available and estimated in the future should be considered, together with the totality of capital plans, revenue income and revenue expenditure forecasts. Set out below are the key indicators for affordability.

15. **Actual and estimates of ratio of financing costs to net revenue stream** – this indicator identifies the trend in the cost of capital (borrowing and other long term liability costs net of investment income) against the net revenue stream. As the Council does not expect to require borrowing to finance capital the ratio for 2014/15 is 0.

16. **Estimates of the incremental impact of capital investment decisions on the council tax** – this indicator identified the revenue costs associated with proposed changes to the capital programme recommended in this budget report. However, as the capital programme is to be financed from internal resources there will be no impact on council tax in 2014/15.

Borrowing limit indicators

17. Within the Prudential Code there are a number of key indicators to ensure the Council operates within well defined borrowing limits.

18. For the first of these the Council needs to ensure that its total borrowing, net of any investments, does not (except in the short term), exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and next two financial years. This is summarised in Table 5.

Table 5: Projected Investments, Borrowing and Capital Financing Requirement

Borrowing & Investment Activity	2012/13 Actual £000	2013/14 Budget £000	2014/15 Budget £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Forecast £000
Investments	48,000	48,000	44,000	48,000	46,000	45,000
Borrowing	0	0	0	0	0	0
Net Investments	48,000	48,000	44,000	48,000	46,000	45,000
Capital Financing Requirement	0	0	0	0	0	0

19. The Finance Manager reports that the Council complied with this Prudential Indicator so far during 2013/14 and does not envisage difficulties for the remainder of the financial year or during the following financial year. This view takes into account current commitments, existing plans, and the proposals in this report.

20. A further two Prudential Indicators control the overall level of borrowing. These are:

The authorised limit: this represents the limit beyond which borrowing is prohibited. Setting this limit is required under section 3 (1) of the *Local Government Act 2003*. It reflects a level of borrowing that could be afforded in the short term, but that is neither sustainable nor desirable. It is the expected maximum borrowing need with some headroom for unexpected events.

Table 6: Authorised Limit for Borrowing

	2012/13 Actual £000	2013/14 Budget £000	2014/15 Budget £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Forecast £000
Authorised Limit for External Debt	25,000	25,000	25,000	25,000	25,000	25,000

The operational boundary: this indicator is based upon the probable external debt during the course of the year. It is not a limit and actual borrowing could exceed this boundary for short times during the year. It should, however, act as an indicator to ensure the authorised limit is not breached.

Table 7: Operational Boundaries for Borrowing

	2012/13 Actual £000	2013/14 Budget £000	2014/15 Budget £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Forecast £000
Operational Boundary for External Debt	15,000	15,000	15,000	15,000	15,000	15,000

21. The level of these controls reflect the day-to-day cash flow operations, the potential for long term borrowing in the future and an allowance to cover the potential shortfall in cash flow arising from the Council's Icelandic investments. Given the current uncertainty surrounding the timing of the recovery of the remaining investments, it is felt prudent to maintain the authorised limit at the level set for 2013/14.

22. The last Prudential Indicator relating to borrowing provides upper limits for fixed and variable interest rate exposure. Since the Council only intends to undertake borrowing at fixed interest rates these will be set at 100% fixed and 0% variable.

23. In addition to the prudential controls above, the Finance Manager (as the Council's s151 officer) is also required to ensure that the Council, as part of its day-to-day treasury operations, does not "on lend" (ie borrow money to invest elsewhere).

REIGATE & BANSTEAD BOROUGH COUNCIL

CASH MANAGEMENT STRATEGY

2014 / 2015

OBJECTIVES

1. The purpose of the Council's cash management strategy is to optimise the flow of cash through the organisation in order to maximise the potential for using it to earn income for the Council.

2. To optimise cash flow, the Council manages both its outflows and inflows:-

    - Outflows (Expenditure): payment to suppliers, employees and other creditors; and
    - Inflows (Income): the identification and collection of money owed to the Council.

3. Effective management of the processes handling the inflows and outflows is a key element of this strategy. The financial policies of the Council are set out in the Financial Procedural Rules within the Constitution. These describe the key control requirements.

4. In addition to sound and well controlled processes it is important that these processes are as efficient as possible. This is achieved through standard, best practice processes, and this is the end to which this strategy strives.

5. In essence the aim is to keep transactional costs low and quality high by automating and embedding standardised best practice processes in all financial activity across the Council.

6. This involves:-

    - Identifying and establishing the one standard process to be used across the Council to deliver best practice;
    - Automating, where possible and cost-effective to do so, thereby increasing productivity and embedding controls, reducing risk of error and the resultant cost of putting it right;
    - Minimising cash transactions thereby reducing both risk and handling costs;
    - Maintaining good customer care, treating all customers fairly, consistently and with respect; and dealing with all queries promptly; and
    - Continuous improvement of the efficiency and productivity of the systems and processes.

7. Objectives specific to the function are as follows:

Payment to Suppliers

- Timely payment of suppliers. This means ensuring payment is made in accordance with the contractual terms of business, taking full advantage of available 'credit' periods but avoiding late payments and potential interest cost under the *Late Payment of Commercial Debts (Interest) Act 1998.*

Collection of Debts

- To ensure that all money owed to the Council is properly and promptly recorded within the Council's debtor systems;
- To take all effective actions to ensure that the money owed is actually received by the Council and as quickly as possible.

Receipts Handling & Banking

- To ensure cash and cheques received are deposited in the Council's bank accounts as promptly as possible;
- To maximise electronic payments.

PERFORMANCE MEASURES / SUCCESS MEASURES

Payment to Suppliers

8. Currently 96.6% of payments are made to suppliers within the contractual timescales against a target of 98%.

9. Electronic payment is efficient, benefiting the Council, and prompt, benefiting the supplier. The Council currently pays 97.7% of the volume of invoices it receives electronically against a target for 2013/14 of 98%.

Collection of Debts

10. The Council already has an excellent record for the recovery of debt; performance is reported quarterly to the Executive to help ensure this is maintained. The level of debt write-off has been under 5% for the last three financial years.

11. The current economic situation is likely to have an ever increasing effect on debt recovery as more organisations and individuals encounter difficulties. Maintaining the high recovery and low write off rates will be a challenge.

12. The target for 2014/15 is to at least maintain these levels.

Receipt Handling & Banking

13. Currently, over 99% of income received by the central income office team is processed and/or banked within 2 working days. The target for 2014/15 is to maintain these levels.

REIGATE & BANSTEAD BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY RISK MANAGEMENT ASSESSMENT

2014 / 2015

PURPOSE

1. The Council's Treasury Management Policy Statement requires that risk issues are fully considered in the development of the Council's Treasury Management Strategy.

2. The Code of Practice on Treasury Management identifies eight key areas of risks that all Public Sector organisations should consider when developing their strategies. These are:-

    i. Credit and counterparty risk management
    ii. Liquidity risk
    iii. Interest rate risk
    iv. Exchange rate risk
    v. Refinancing risk
    vi. Legal and regulatory risk
    vii. Fraud, error and corruption and contingency management
    viii. Market risk

3. The purpose of this statement is to assess and then set out the Council's current position regarding the potential impact that the above risks will have on its Treasury Management activity during 2014/15.

RISK ASSESSMENT

Credit and Counterparty Risk

4. This is the risk of failure by a Counterparty to meet its contractual obligations to the Council under an investment, borrowing or other financing agreement; particularly as a result of the counterparty's diminished creditworthiness and resulting in a detrimental effect on the Council's capital or revenue resources.

5. This is the main risk faced by all public sector organisations and highlighted by the recent banking crisis. Therefore the Council needs to ensure that it has appropriate controls in place to both avoid entering agreements with Counterparties that are showing the signs of financial problems and to minimise any impact on the Council should the risk materialise by limiting the value of any potential exposure.

6. Given continuing concerns over the need to maintain security and guarantee assurance about the safety of the capital investment, this creates a risk that the "credit quality" requirements will limit the number of potential counterparties to an extent that the Council is forced to invest in organisations and institutions (such as the Debt Management Office) where investment returns would be very low.

7. Another example of this is the use of Building Societies where there is mixed advice coming from the market professionals on whether Local Authorities should only invest with Societies that have acquired a formal 'Credit Rating'. Building Societies are only required to obtain a formal rating if they wish to transact money deals in the international 'wholesale' market. Therefore limiting the Council's exposure to only these Building Societies could be viewed as indirectly increasing the Council's risk exposure. Conversely, Building Societies without a formal credit rating may limit their money deals to working with UK institutions and organisations. This could be viewed as a positive point given the current economic market.

Liquidity Risk

8. This is the risk that cash will not be available when it is actually needed to make payments. Since the authority is debt free and does not have a capital financing requirement (CFR) it is not foreseen that this will be an issue. The authorised borrowing limit provides cover for any short-term cash flow issues that arise.

9. In addition, the Council maintains both an annual and 5-year cash flow model which helps to identify when cash will be required.

10. It is acknowledged that the Council with its Prudential Borrowing powers does have access to cash, if required, to fund a short term need. This provides more flexibility when considering the length of time over which to place investments.

Interest Rate Risk

11. This is the risk that movements in interest rates will adversely affect the financial position of the authority. As all the Council's investments are fixed rate or structured/stepped this avoids immediate exposure to fluctuations in interest rates. The maturity profile on investments and the use of investment managers also reduces the impact when the investment matures and requires placement back into the market.

12. The table overleaf highlights the estimated impact of a full percentage point increase/decrease in all interest rates to treasury management costs/income for next year. The figures are based on all the investments that are due to come to maturity within the next twelve months.

Table 1: Impact of Changes in Interest Rates

	2014/15 Estimated + 1% Point	2014/15 Estimated - 1% Point
Revenue Budgets		
Interest on (long-term) borrowing	0	0
Investment income	£480,000	-£480,000

Exchange Rate Risk

13. This risk relates to the potential loss of money from fluctuations in foreign exchange rates where money has been traded in other national currencies. This is not applicable as the Council's current policy is to only invest or borrow money in Sterling.

Refinancing Risk

14. This relates to borrowing money, and reflects the risk that maturing borrowing arrangements cannot be refinanced on terms that reflect the provision made for refinancing and that the terms may not be consistent with prevailing market conditions at the time.

15. This is not currently a risk for this Council to be concerned about, as we do not have any long-term borrowings.

Legal and Regulatory Risk

16. This is the risk that the Council or an organisation that is it dealing with, fails to act in accordance with its legal powers or regulatory requirements and that the Council suffers losses accordingly.

17. The Council's Constitution, through its Financial Procedure Rules together with the Council's Treasury Management Policy Statement provide the governance framework to ensure that the Council acts at all time in a legal manner.

18. The 'Credit Quality' checks undertaken on all potential counterparties include a check that they are legally able to transact financial arrangements with public sector organisations. This is also mitigated by limiting the Council's counterparty list.

Fraud, Error and Corruption and Contingency Management Risk

19. This risk relates to the failure of the Council to identify the circumstances in which it may be exposed to the risk of loss through fraud, error or corruption or other eventualities in its treasury management dealings; and fails to employ suitable systems and procedures and maintain effective contingency management arrangements to these ends. It includes the area of risk commonly referred to as 'operational' risk.

20. It is difficult for any public sector organisation to fully protect itself against these risks. The most effective way is to ensure that it has fully robust and fully documented procedures that ensure that more than one person is involved in any treasury management transaction.

21. The Council's procedures are set out in its Treasury Management Practice statements which are reviewed regularly by Senior Management and are subject to separate approval by the Executive and review by the Overview & Scrutiny Committee.

22. In addition, the Internal Audit Service undertakes an annual audit to ensure that all transactions comply with documented procedures and the Council's Treasury Management Policy Statement. Overview and Scrutiny Committee receive reports on Internal Audit activity.

Market Risk

23. Market risk is defined as the possibility that the value of an instrument (investment) will fluctuate because of changes in market conditions. As the Council only deals in fixed term arrangements where the interest rate liability is fixed (or fixed periodically within a range for stepped investments), then this risk is not applicable.

CONCLUSION

24. The above risks have a greater impact on the Council's approach to investments than its borrowing. To further add understanding of the impact and the control measures in place to mitigate the risks a risk assessment schedule of the outcome is set out on Appendix 1 to the Investment Strategy.

25. Overall this shows that the Council has a clear understanding of the potential risks and has fully considered ways of addressing them.

REIGATE & BANSTEAD BOROUGH COUNCIL

ECONOMIC UPDATE SECTOR 2014 / 2015

1. The information contained within this section has been provided by the Council's treasury management advisors, Sector. The money rates quoted are their assessment of what the average 'market' rates will be for that period.
2. The following table was provided by Sector in October 2013 and is the latest information received from them.

Medium-Term Rate Estimates

	Oct-13 Actual	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3m LIBID	0.39	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
6m LIBID	0.47	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.70
12m LIBID	0.75	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.90	1.00	1.20
5yr PWLB	2.38	2.50	2.50	2.60	2.70	2.70	2.80	2.80	2.90	3.00	3.20
10yr PWLB	3.52	3.70	3.70	3.70	3.80	3.80	3.90	4.00	4.10	4.20	4.30
25yr PWLB	4.29	4.40	4.40	4.40	4.50	4.50	4.60	4.70	4.80	4.90	5.00
50yr PWLB	4.33	4.40	4.40	4.40	4.50	4.60	4.70	4.80	4.90	5.00	5.10

*PWLB Rates are borrowing rates.

Economic performance to date

3. Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded in quarter 1 (+0.3%) and 2 (+0.7%) of 2013 to surpass all expectations as all three main sectors, services, manufacturing and construction contributed to this strong upturn. The August 2013 Bank of England Inflation Report consequently upgraded growth forecasts for 2013 from 1.2% to 1.4% and for 2014 from 1.7% to 2.5%. However, Bank Governor Mark Carney put this into perspective by describing this welcome increase as not yet being "escape velocity" to ensure we return to strong AND sustainable growth. However, growth is expected to be strong for the immediate future.

4. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth.

5. **The Eurozone.** The sovereign debt crisis has eased during 2013 which has been a year of comparative calm after the hiatus of the Cyprus bailout in the spring. The EZ finally escaped from seven quarters of recession in quarter 2 of 2013 but growth is likely to remain weak and so will dampen UK growth. The ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bail out, has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2012 figures) of 176% Greece, Italy 131%, Portugal 124%, Ireland 123% and Cyprus 110%, remain a cause of concern, especially as many of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are continuing to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis.

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

7. The Bank of England also issued forward guidance with this Inflation Report which said that the Bank will not start to consider raising interest rates until the jobless rate has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years. The UK unemployment rate currently stands at 2.5 million or 7.7%. The Bank's guidance is subject to three provisos, mainly around inflation; breaching any of them would sever the link between interest rates and unemployment levels. This actually makes forecasting Bank Rate much more complex given the lack of available reliable forecasts by economists over a three year plus horizon. The recession since 2007 was notable for how unemployment did NOT rise to the levels that would normally be expected in a major recession and the latest Inflation Report noted that productivity had sunk to 2005 levels. There has therefore been a significant level of retention of labour, which will mean that a significant amount of GDP growth can be accommodated without a major reduction in unemployment. The forecast in this report for Bank Rate not to start increasing until quarter 3 of 2016 is based on a slow reduction of unemployment, (in line with the Bank of England's forecast), and contrary to

the prevalent market view where rates are indicating that Bank Rate is expected to start going up in early 2015.

8. **Inflation**. Inflation has fallen from a peak of 3.1% in June 2013 to 2.7% in September. It is expected to fall back to reach the 2% target level within the two year horizon.
9. **AAA rating**. The UK has lost its AAA rating from Fitch and Moody's but that caused little market reaction.

Outlook for the next six months of 2013/14

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

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

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

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

    Downside risks currently include:

    - The conflict in the UK between market expectations of how quickly unemployment will fall as opposed to the Bank of England's forecasts

    - Prolonged political disagreement over the US Federal Budget and raising the debt ceiling

- A return to weak economic growth in the US, UK and China causing major disappointment to investor and market expectations.

- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.

- The Italian political situation is frail and unstable.

- Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts.

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

- Weak growth or recession in the UK's main trading partners - the EU and US, depressing economic recovery in the UK.

- Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds

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

- A sharp upturn in investor confidence that sustainable robust world economic growth is firmly expected, causing a surge in the flow of funds out of bonds into equities.

- A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone.

- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt, consequent upon repeated failure to achieve fiscal correction targets and sustained recovery of economic growth which could result in the ratio of total government debt to GDP to rise to levels that undermine investor confidence in the UK and UK debt.

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

- In the longer term – an earlier than currently expected reversal of QE in the UK; this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.