TREASURY MANAGEMENT STRATEGY STATEMENT

AND

ANNUAL INVESTMENT STRATEGY

2013/14

Treasury Management Strategy Statement, Minimum Revenue Provision (MRP) Strategy and Annual Investment Strategy 2013/14

1. Introduction

1.1 Background

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

The second main function of the treasury management service is the funding of capital expenditure plans. However, the City is not anticipating any borrowing at this time.

1.2 The treasury management policy statement

The City defines its treasury management activities as:

1. The management of the organisation's investments and cash flows, its banking, money market and capital market transaction; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.
2. The City regards the security of its financial investments through 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. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
3. The City acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

1.3 Statutory Requirements

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

The Act therefore requires the City to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment

Guidance subsequent to the Act and included as paragraph 9 of this report); this sets out the City's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.4 CIPFA Requirements

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by the Court of Common Council (the Court) on 3 March 2010:

The primary requirements of the Code are as follows:

(i) The City of London Corporation will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

(ii) This organisation (ie the Court of Common Council) will receive reports on its treasury management policies, practices and activities, including as a minimum an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

(iii)The Court of Common Council delegates responsibility for the implementation and regular monitoring of its treasury management policies to the Finance Committee and the Financial Investment Board and for the execution and administration of treasury management decisions to the Chamberlain, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

(iv) The Court of Common Council nominates the Audit and Risk Management Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

1.5 Treasury Management Strategy for 2013/14

The Local Government Act 2003 (the Act) and supporting regulations require the City to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the City's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Court of Common Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) (included as paragraph 7 of this report); this sets out the City's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2013/14 in respect of the required aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the City's treasury adviser, Sector Treasury Services.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the City
- Treasury Indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers.

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

1.6 Balanced Budget Requirement

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

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the City for the foreseeable future.

1. Treasury Limits for 2013/14 to 2015/16

It is a statutory duty under Section 3 of the Act and supporting regulations, for the City to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

The City must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is ‘acceptable’.

Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years; details of the Authorised Limit can be found in appendix 3 of this report.

2. Current Portfolio Position

The City’s treasury portfolio position at 13 January 2013 comprised:

Table 1		**Principal**		**Ave. rate**
		£m	**£m**	**%**
Fixed rate funding	PWLB	0		
	Market	0	0	-
Variable rate funding	PWLB	0	0	-
	Market	0	0	-
Other long term liabilities			0	
Gross debt			**0**	**-**
Total investments			**651.3**	**2.0**
Net Investments			**651.3**	

3. Treasury Indicators for 2013/14 – 2015/16

Treasury Indicators (as set out in tables 1 and 2 in appendix 2 to this report) are relevant for the purposes of setting an integrated treasury management strategy.

The City is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted by the Court of Common Council on 9 March 2004 and the revised 2009 Code was adopted on 3 March 2010.

4. Prospects for Interest Rates

The City of London has appointed Sector as its treasury advisor and part of their service is to assist the City to formulate a view on interest rates. Appendix 1 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Sector central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates		
		5 year	25 year	50 year
Dec 2012	0.50	1.50	3.70	3.90
March 2013	0.50	1.50	3.80	4.00
June 2013	0.50	1.50	3.80	4.00
Sept. 2013	0.50	1.60	3.80	4.00
Dec 2013	0.50	1.60	3.80	4.00
March 2014	0.50	1.70	3.90	4.10
June 2014	0.50	1.70	3.90	4.10
Sept. 2014	0.50	1.80	4.00	4.20
Dec 2014	0.50	2.00	4.10	4.30
March 2015	0.75	2.20	4.30	4.50
June 2015	1.00	2.30	4.40	4.60
Sept. 2015	1.25	2.50	4.60	4.80
Dec 2015	1.50	2.70	4.80	5.00
March 2016	1.75	2.90	5.00	5.20

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

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

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

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

5. Borrowing Strategy

It is anticipated that there will be no capital borrowings required during 2013/14.

7. Annual Investment Strategy

7.1 Investment Policy

The City of London's investment policy will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes ("the CIPFA TM Code"). The City's investment priorities are:

(a) the security of capital and

(b) the liquidity of its investments.

The City will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of the City is low in order to give priority to security of its investments.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and the City will not engage in such activity.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the City has clearly stipulated below the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings and watches published announcements by all three ratings agencies with a full understanding of what the ratings reflect in the eyes of each agency. Using the Sector ratings service potential counterparties ratings are monitored on a real time basis with knowledge of any changes notified electronically when the agencies issue modifications.

Further, the City's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the City will engage with its advisors to maintain a monitor on market pricing such as "Credit Default Swaps" and use that information alongside the credit ratings.

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

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

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

Investment instruments identified for use in the financial year are listed in appendix 3 / 4 under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits are set within these appendices.

7.2 Creditworthiness policy

The City uses the creditworthiness service provided by Sector Treasury Services. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as 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.

The City will not specifically follow the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys tends to be more aggressive in giving lower ratings than the other two agencies. Otherwise, the City would have difficulty in forming its approved lending list as there would be too few counterparties with an associated investment concentration risk. The Sector creditworthiness services does though, incorporate ratings from all three agencies, but by using a risk weighted scoring system, does not give undue preponderance to just one agency’s ratings.

All credit ratings will be monitored on a daily basis**.** The City is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the City’s minimum criteria, its further use as a possible investment will be withdrawn immediately.
- In addition to the use of Credit Ratings the City 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 and possible removal from the City lending list.

Sole reliance will not be placed on the use of this external service. In addition the City will also use market data and market information, information on government support for banks and the credit ratings of that government support. Regular meetings are held involving the Chamberlain, Financial Services Director, Corporate Treasurer and Members of the Treasury Team, when the suitability of prospective counterparties and the optimum duration for lending is discussed and agreed.

The primary principle governing the City'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 City 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.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the City's prudential indicators covering the maximum principal sums invested.

The Chamberlain will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Financial Investment Board as necessary. These criteria are separate to those which determine which types of investment instruments are classified as either specified or non-specified and in so doing provides an overall pool of counterparties considered high quality which the City may use, rather than defining which specific types of investment instruments are to be used.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) are:

- Banks 1 – good credit quality – the City will only use banks which:
  (i) are UK banks; and/or
  (ii) are non-UK and domiciled in a country which has a minimum sovereign long-term rating of AAA (Fitch rating)
  and have, as a minimum the following Fitch credit rating:
  (i) Short-term F1
  (ii) Long-term A
  (iii) Viability/financial strength bbb
  (iv) Support 3

- Banks 2 – Part Nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised, or they meet the ratings in Banks 1 above.

- Banks 3 – The City's own banker for transactional purposes if the bank falls below the above criteria, although in this case, balances will be minimised in both monetary size and duration.

- Bank subsidiary and treasury operation. The City will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above. This criteria is particularly relevant to City Re Limited, the City's Captive insurance company, which deposits funds with bank subsidiaries in Guernsey.

- Building Societies – The City may use all societies which:
  (i) meet the ratings for banks outlined above; or
  (ii) have assets in excess of £9bn.

- Money Market Funds – with minimum credit ratings of AAA

- UK Government – including government gilts and the debt management agency deposit facility.

- Local authorities.

A limit of £300m will be applied to the use of non-specified investments.

7.3 Country limits

The City has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide a rating). The counterparty list, as shown in Appendix 6, will be added to or deducted from by officers should individual country ratings change in accordance with this policy. It is proposed that the UK will be excluded from this stipulated minimum sovereign rating requirement should the UK be downgraded.

7.4 Investment Strategy

In-house funds: The City's in-house managed funds are both cash-flow derived and also represented by core balances which can be made available for investment over a 2-3 year period. Investments will accordingly 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).

The City currently has a number of term deposits which span the 2013/14 financial year, as follows:

Borrower	**Amount £m**	**Maturity**	**Rate %**
Royal Bank of Scotland	10.0	22 December 2014	3.80
	10.0	22 December 2014	3.80
	12.2	22 December 2014	3.80
	10.0	05 January 2014	3.95
	10.0	05 January 2014	3.95
	10.0	05 January 2014	3.95
	12.1	05 January 2014	3.95
TOTAL	**74.3**		

7.5 Investment returns expectations: Bank Rate has been unchanged at 0.50% since March 2009. Bank Rate is forecast by Sector Treasury Services to remain unchanged at 0.5% before starting to rise from quarter 4 of 2014. Bank Rate forecasts for financial year ends (March) are as follows:

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

Sector considers that there is downside risk to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England 2% target rate.

The Chamberlain and his Treasury Officers consider there is a likelihood of interest rates remaining at very low levels for some considerable time, and in view of the importance of interest earnings included in forward financial forecasts, opportunities have been taken to lock-in some of the 'core balances' cash holdings to 2 and 3 year deals when attractive interest rates have been available.

For 2012/13 the City has budgeted for an average investment return of 2.00% on investments placed during the financial year and previously. Financial forecasts for the period 2013/14 to 2015/16 also include interest earnings based on an average investment return of 1.5%.

For its cash flow generated balances, the City will seek to utilise its business reserve accounts, money market funds, and short-dated deposits (overnight to twelve months) in order to benefit from the compounding of interest.

7.6 Investment Treasury Indicator and Limit

Total principal funds invested for greater than 364 days are subject to a limit, set with regard to the City's liquidity requirements and to reduce the need for an early sale of an investment, and are based on the availability of funds after each year end.

The Board is asked to approve the treasury indicator and limit:

Maximum principal sums invested for more than 364 days (upto three years)

£m	2013/14 (£m)	2014/15 (£m)	2015/16 (£m)
Principal sums invested >364 days	300	300	300

7.7 End of year investment report

At the end of the financial year, the City will report on its investment activity as part of its Annual Treasury Report.

7.8 External fund managers

A proportion of the City's funds, amounting to £201.2m as at 13 January 2013, are externally managed on a discretionary basis by Ignis Asset Management, Invesco, Prime Rate, CCLA Liquidity Fund and Payden Global Funds Plc. It is being proposed that two additional Money Market Fund Managers, Goldman Sacs and Insight, are added to the list for 2013/14 to aid diversification.

The City's external fund managers will comply with the Annual Investment Strategy, and the fund managers additionally stipulate guidelines and duration and other limits in order to contain and control risk. Investments made by the Money Market Fund Managers include a diversified portfolio of very high quality sterling-dominated investments, including gilts, supranationals, bank and corporate bonds, as well as other money market securities. The individual investments held within the Money Market Funds are monitored on a regular basis by Treasury staff.

The minimum credit criteria to be used for the selection of the cash fund manager(s) are based on Fitch Ratings and is AAA/mmf. The Payden Sterling Reserve Fund is rated by Standard and Poors at AAA/mmf.

7.9 Policy on the use of external service providers

The City uses Sector Treasury Services as its external treasury management advisers.

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

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The City 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.

7.10 Scheme of delegation

Please see appendix 8.

7.11 Role of the Section 151 officer

Please see appendix 9.

APPENDICES

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APPENDIX 1: Interest Rate Forecasts 2013 – 2016

Sector's Interest Rate View	Now	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
3 Month LIBID	0.39%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%	1.40%	1.70%
6 Month LIBID	0.54%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%	1.60%	1.90%
12 Month LIBID	0.88%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%	1.80%	2.10%
5yr PWLB Rate	1.85%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
10yr PWLB Rate	2.87%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
25yr PWLB Rate	4.02%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
50yr PWLB Rate	4.15%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
Bank Rate														
Sector's View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate														
Sector's View	1.85%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%	2.50%	2.70%	2.90%
UBS	1.85%	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	1.85%	1.55%	1.30%	1.30%	1.30%	1.30%	1.30%	1.50%	1.60%	-	-	-	-	-
10yr PWLB Rate														
Sector's View	2.87%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%	3.50%	3.70%	3.90%
UBS	2.87%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	-	-	-	-	-
Capital Economics	2.87%	2.55%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	-	-
25yr PWLB Rate														
Sector's View	4.02%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%	4.60%	4.80%	5.00%
UBS	4.02%	4.20%	4.30%	4.40%	4.50%	4.50%	4.50%	4.50%	4.50%	-	-	-	-	-
Capital Economics	4.02%	3.70%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-	-	-	-	-
50yr PWLB Rate														
Sector's View	4.15%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%	4.80%	5.00%	5.20%
UBS	4.15%	4.30%	4.40%	4.50%	4.60%	4.60%	4.60%	4.60%	4.60%	-	-	-	-	-
Capital Economics	4.15%	4.00%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

APPENDIX 2: Economic Background

The Global economy

The Eurozone debt crisis has continued to cast a pall over the world economy and has depressed growth in most countries. This has impacted the UK economy which is unlikely to have grown significantly in 2012 and is creating a major headwind for recovery in 2013. Quarter 2 of 2012 was the third quarter of contraction in the economy; this recession is the worst and slowest recovery of any of the five recessions since 1930. A return to growth @ 0.9% in quarter 3 is unlikely to prove anything more than a washing out of the dip in the previous quarter before a probable return to negative growth in quarter 4; this would leave overall growth in 2012 close to zero and could then lead into negative growth in quarter 1 of 2013, which would then mean that the UK was in its first triple dip recession since records began in 1955.

The **Eurozone sovereign debt crisis** abated following the ECB's commitment to a programme of Outright Monetary Transactions i.e. a pledge to buy unlimited amounts of bonds of countries which ask for a bailout. The immediate target for this statement was Spain which continues to prevaricate on making such a request, (for a national bailout), and so surrendering its national sovereignty to IMF supervision. However, the crisis in Greece has subsided, for the time being, as a result of the Eurozone agreement to provide a further €50bn financial support package in December. Many commentators, though, still view a Greek exit from the Euro as being likely in the longer term as successive rounds of austerity packages could make it more difficult to bring down the annual deficit and total debt as ratios of GDP due to the effect they have on shrinking the economy and reducing employment and tax revenues. However, another possible way out would be a major write down of total Greek debt; this has now been raised by the German Chancellor as a possible course of action, but not until 2014-15, and provided the Greek annual budget is in balance.

Sentiment in financial markets has improved considerably since this ECB action and additional financial support for Greece to ensure that the Eurozone remained intact during 2012. However, the foundations to this "solution" to the Eurozone debt crisis are still weak and do not address the huge obstacle of unemployment rates of over 25% in Greece and Spain. It is also possible that the situations in Portugal and Cyprus could deteriorate further in 2013 and, although they are minor economies, such developments could unnerve financial markets. There are also general elections coming up in Italy and Germany which could potentially produce some upsets on the political scene. It is, therefore, quite possible that sentiment in financial markets could turn during 2013 after the initial burst of optimism at the start of the year. While equity prices have enjoyed a strong start to 2013, the foundations for this stock market recovery are shallow given the economic fundamentals in western economies. In addition, QE has to come to an end at some point in time and there is a distinct increase in doubt in the central banks of the US and UK as to the effectiveness of any further QE in stimulating economic growth. An end to central purchases of bonds may lead to a fall in bond prices.

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

Hopes for a broad based recovery have, therefore, focused on the **emerging markets**. Recent news from China appears to indicate that the economy has returned to a healthier rate of growth. However, there are still concerns around the unbalanced nature of the economy which is heavily dependent on new investment expenditure. The potential for the bubble in the property sector to burst, as it did in Japan in the 1990s, could have a material impact on the economy as a whole.

The UK economy

The Government's austerity measures, aimed at getting the public sector deficit into order, have now had to be extended, in the autumn statement, over a longer period than the original four years. Achieving this new extended timeframe will still be dependent on the UK economy returning to a reasonable pace of growth towards the end of this period.

Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is seen as a safe haven from Eurozone debt. However, the subsiding of market concerns over the Eurozone has unwound some of the attractiveness of gilts as a safe haven and led to a significant rise in gilt yields. There is little evidence that UK consumer confidence levels are recovering, nor that the manufacturing sector is picking up. The dominant services sector disappointed in December with the PMI survey indicating the first fall in activity in two years. On the positive side, banks have made huge progress since 2008 in shrinking their balance sheets to more manageable levels and also in reducing their dependency on wholesale funding. However, availability of credit remains tight in the economy and the Funding for Lending scheme, which started in August 2012, has not yet had time to make a significant impact in respect of materially increasing overall borrowing in the economy. Finally, the housing market remains tepid and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth. Economic growth has basically flat lined since the election of 2010 and, worryingly, the economic forecasts for 2012 and beyond were revised substantially lower in the Bank of England Inflation quarterly report for August 2012 and were then further lowered in the November Report. Quantitative Easing (QE) increased by £50bn in July 2012 to a total of £375bn. Many forecasters are expecting the MPC to vote for a further round of QE in early 2013 to try to stimulate economic activity. The announcement in November 2012 that £35bn will be transferred from the Bank of England's Asset Purchase Facility to the Treasury (representing coupon payments to the Bank by the Treasury on gilts held by the Bank) was also effectively a further addition of QE.

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

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

AAA rating. The UK continues to enjoy an AAA sovereign rating. However, the three main credit rating agencies have stated that they will be reviewing this rating in early 2013; they will, thereafter, also be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years.

Sector's forward view

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

- the potential for the Eurozone to withdraw support for Greece at some point if the Greek government was unable to eliminate the annual budget deficit and the costs of further support were to be viewed as being prohibitive, so causing a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself. The same considerations could also apply to Spain;

- inter government agreement on how to deal with the overall Eurozone debt crisis could fragment;

- the impact of the Eurozone crisis on financial markets and the banking sector;

- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to manufactured goods;

- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that are unlikely to be achieved;

- the risk of the UK's main trading partners, in particular the EU and US, falling into recession;

- stimulus packages failing to stimulate growth;

- elections due in Italy and Germany in 2013;

- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China;

- the potential for action to curtail the Iranian nuclear programme;

- the situation in Syria deteriorating and impacting other countries in the Middle East.

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

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

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

- UK inflation being significantly higher than in the wider EU and US causing an increase in the inflation premium in gilt yields;

- Reversal of QE; this could initially be allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held;

- Reversal of Sterling's safe haven status on an improvement in financial stresses in the Eurozone;

- Investors reverse de-risking by moving money from government bonds into shares in anticipation of a return to worldwide economic growth;

- The possibility of a UK credit rating downgrade.

APPENDIX 3 - Treasury Indicators

TABLE 1: TREASURY MANAGEMENT INDICATORS	2011/12	2012/13	2013/14	2014/15	2015/16
	actual	probable outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
borrowing	£0	£0	£0	£0	£0
other long term liabilities	£0	£0	£0	£0	£0
TOTAL	£0	£0	£0	£0	£0
Operational Boundary for external debt -					
borrowing	£0	£0	£0	£0	£0
other long term liabilities	£0	£0	£0	£0	£0
TOTAL	£0	£0	£0	£0	£0
Actual external debt	£0	£0	£0	£0	£0
Upper limit for fixed interest rate exposure					
expressed as either:-					
Net principal re fixed rate borrowing / investments OR:-	100%	100%	100%	100%	100%
Net interest re fixed rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
expressed as either:-					
Net principal re variable rate borrowing / investments OR:-	100%	100%	100%	100%	100%
Net interest re variable rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for total principal sums invested for over 364 days	£300m	£300m	£300m	£300m	£300m
(per maturity date)					

TABLE 2: Maturity structure of fixed rate borrowing during 2012/13	upper limit	lower limit
under 12 months	0%	0%
12 months and within 24 months	0%	0%
24 months and within 5 years	0%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%

APPENDIX 4 – Treasury Management Practice (TMP1)

- Credit and Counterparty Risk Management, Specified and Non-Specified Investments and Limits

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where appropriate.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of £300m will be held in aggregate in non-specified investment.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

SPECIFIED INVESTMENTS:
(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	*** Minimum 'High' Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies, including part nationalised banks	Short-term F1, Long-term A, Viability bbb, Support 3	In-house
Term deposits – banks and building societies, including part nationalised banks	Short-term F1, Long-term A, Viability bbb, Support 3	Fund Managers
Money Market Funds	AAA	In-house and Fund Managers
UK Government Gilts	UK Sovereign Rating	In-house & Fund Managers
Treasury Bills	UK Sovereign Rating	Fund Managers
Sovereign Bond issues (other than the UK government)	AAA	Fund Managers

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment Criteria with maturities in excess of 1 year. A maximum of £300m will be held in aggregate in non-specified investments.

	* Minimum Credit Criteria	Use	Maximum	Maxiumum Maturity Period
Term deposits - other LAs (with maturities in excess of one year)	-	In-house	£25m per LA	Three years
Term deposits, including callable deposits - banks and building societies (with maturities in excess of one year)	Long-term A, Short-term F1, Viability bbb, Support 3	In-house and Fund Managers	£300m overall	Three years
Certificates of deposits issued by banks and building societies with maturities in excess of one year	Long-term A, Short-term F1, Viability bbb, Support 3	In-house on a buy-and-hold basis and fund managers	£50m overall	Three years
UK Government Gilts with maturities in excess of one year	AAA	In-house on a buy-and-hold basis and fund managers	£50m overall	Three years

APPENDIX 5 – Approved Counterparties and Countries for Investments

BANKS AND THEIR WHOLLY OWNED SUBSIDIARIES

FITCH RATINGS	BANK CODE	MMS CODE	LIMIT OF £100M PER GROUP (£150m for Lloyds TSB Bank)	BALANCES 13 Jan 2013 £m	Duration
AA - F1 + a + 1	40.53.71	FA	HSBC ----------------------------------	- ==========	Up to 3 years
A F1 a 1	20.00.00 20.00.52	CA	BARCLAYS CAPITAL BARCLAYS BANK -------------------------------	18.0 81.3 ==========	Up to 3 years
A F1 bbb 1	30.15.57	LJ	LLOYDS TSB BANK incl. Bank of Scotland -----------------------------	143.3 =========	Up to 3 years
A F1 bbb 1	16.75.75	RA	ROYAL BANK OF SCOTLAND RBOS SETTLEMENTS	13.1 74.3	Up to 3 years
A - F1 ccc 1	98.00.05	LX	ULSTER BANK	1.6 ------------------	On Hold
			TOTAL ---	331.6 ==========	

BUILDING SOCIETIES

FITCH RATINGS	GROUP	ASSETS £bn	LIMIT £m	BALANCES 13 Jan. 2013 £m	Duration
A + F1 a + 1	Nationwide	196	120	118.5	Up to 3 years
BBB + F2 bbb + 5	Yorkshire	33	20	-	Upto 1 year
A F1 a 5	Coventry	24	20	-	Upto 1 year
BBB - F3 bbb – 5	Skipton	14	20	-	Upto 1 year
A – F2 a - 5	Leeds	10	20	-	Upto 1 year
				118 .5	

FITCH RATINGS	MONEY MARKET FUNDS Overall Limit £250m	BALANCES 13 Jan 2013 £m	DURATION
AAA/mmf	Insight Investment Liquidity Fund	0	Liquid
AAA/mmf	Goldman Sacs Sterling Liquidity Reserve Fund	0	Liquid
AAA/mmf	CCLA	10.0	Liquid
AAA/mmf	Prime Rate Liquidity Fund	49.9	Liquid
AAA/F1+	Deutsche Liquid Assets Fund	0	Liquid
AAA/mmf	Ignis Asset Management Liquidity Fund	73.0	Liquid
AAA/mmf	Invesco	13.3	Liquid
AAA / f	Payden Sterling Reserve Fund	55.0	Liquid
	TOTAL	**201.2**	**Liquid**

FOREIGN BANKS
(with a presence in London)

FITCH RATINGS	BANK CODE	MMS CODE		LIMIT £M	BALANCES 15 Jan.2012 £m	Duration
			AUSTRALIA			
AA- F1+ aa - 1	20.32.5 3	NZ	AUSTRALIA & NZ BANKING GROUP	25	Nil =========	Up to 3 years
AA F1+ aa 1	16.55.9 0	EQ	NATIONAL AUSTRALIA BANK	25	Nil =========	Up to 3 years
			NETHERLANDS			
AAA F1+ 1			BANK NEDERLANDSE GEMEENTEN	25	Nil ========	Up to 3 years
			SWEDEN			
AA- F1+ aa - 1	40.51.6 2	EB	SVENSKA HANDELSBANKEN	25	Nil ========	Up to 3 years
			TOTAL		**0**	

LOCAL AUTHORITIES

FITCH RATINGS	BANK CODE	MMS CODE	LIMIT OF £25M PER AUTHORITY	BALANCES	NOTES
			Any UK local authority		

NB. DO NOT LEND TO THE FOLLOWING LOCAL AUTHORITIES

APPENDIX 6 - Approved Countries for Investments – Based on Fitch Ratings

AAA

- Australia
- Canada
- Denmark
- Finland
- France
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- UK
- USA

Appendix 7 - Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The CLG issued Investment Guidance in 2010, and this forms the structure of the City's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current 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 the City to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, will apply its principles to all investment activity. In accordance with the Code, the Chamberlain has produced its Treasury Management Practices (TMPs). These cover investment counterparty policy requiring approval each year.

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

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the City will use. These are high security (i.e. high credit rating, although this is defined by the City, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- 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.

The investment policy proposed for the City is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, 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 are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. A body that is considered of a high credit quality (such as a bank or building society). For category 5 this covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Fitch rating agencies.
5. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. This covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the City has set additional criteria to set the time and amount of monies which will be invested in these bodies. The criteria limits investments to £100m per group for UK banks and their wholly owned subsidiaries and £150m for Lloyds TSB banking group, £120m for Nationwide Building Society, £20m for other building societies, £25m for foreign banks with a presence in London and £250m overall for Money Market Funds. For building societies which do not meet the minimum credit rating criteria, an asset holding of £9+bn can act as a substitute rating.

Non-Specified Investments – 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 below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
	A local authority, parish council or community council	£25m per local authority
	Any **bank or building society** that has a minimum long term credit rating of A, viability rating of bbb and support 1 for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£300m overall
	Gilt edged securities with a maturity of greater than one year. 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.	AAA long term sovereign ratings Maximum duration of upto 3 years
	The **City's own banker** if it fails to meet the basic credit criteria. In this instance, balances will be minimised as far as is possible.	-

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The City receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Corporate Treasurer upon repayment of any outstanding deposits but no new investments will be placed with them. If required, new counterparties which meet the criteria will be added to the list.

Use of External Fund Managers – It is the City's policy on a regular basis to consider the use of external fund managers for a part or the whole of its cash investment portfolio. No funds are managed externally in an external segregated portfolio at the present time, other than the pooled Money Market Funds.

APPENDIX 8 – Treasury Management Scheme of Delegation

The roles of the various bodies of the City of London Corporation with regard to treasury management are:

(i) Court of Common Council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.

(ii) Financial Investment Board and Finance Committee

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit & Risk Management Committee

- Reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- Working closely with and considering recommendations of the Section 151 officer on the compliance with legal statute and statements of recommended practice.

APPENDIX 9 - The Treasury Management Role of the Section 151 Officer

The Chamberlain

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