

SPECIFIED AND NON-SPECIFIED INVESTMENTS

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.

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

Investment	Minimum Credit Criteria / Colour Band	£ limit per institution	Max maturity period
Debt Management Agency Deposit Facility	N/A	£2.5m	6 months
Term deposits – local authorities	N/A	£2.5m	1 year
Term deposits - UK part nationalised banks	Blue **	£3.0m	1 year
Term deposits – banks and building societies	Orange Red Green No colour	£2.5m	Up to 1 year Up to 6 months Up to 100 days Not for use
Money Market Funds	AAA	£2.5m	Liquid

**only applies to nationalised or semi nationalised UK Banks

NON-SPECIFIED INVESTMENTS

A maximum of £1.0m will be held in aggregate in non-specified investment

1. Maturities of ANY period

Investment	Minimum Credit Criteria / Colour Band	Maximum Investment	Maximum maturity period
Certificates of deposits issued by banks and building societies	Green	£1.0m	Up to 2 years
UK Government Gilts	Sovereign rating	£1.0m	Up to 2 years
Bonds issued by multilateral development banks	AAA	£1.0m	Up to 2 years
Bonds issued by a financial institution which is explicitly guaranteed by the UK government	Sovereign rating	£1.0m	Up to 2 years
Fixed term deposits with variable rate and variable maturities:			
Structured deposits	Green	£1.0m	Up to 2 years
Commercial paper issuance by UK banks covered by UK Government guarantee	Green	£1.0m	Up to 2 years
Other debt issuance by UK banks covered by UK Government guarantee	Green	£1.0m	Up to 2 years

2. Maturities in excess of 1 year

Investment	Minimum Credit Criteria	Maximum Investment	Maximum maturity period
Term deposits – local authorities	N/A	£1.0m	Up to 2 Years
Term deposits – banks and building societies	Purple	£1.0m	Up to 2 Years

APPROVED COUNTRIES FOR INVESTMENT

Based on lowest available rating

AAA Rating

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

AA+ Rating

- France
- Hong Kong
- U.K.
- U.S.A.

AA Rating

- Abu Dhabi (UAE)

AA- Rating

- Belgium
- Saudi Arabia

TREASURY MANAGEMENT SCHEME OF DELEGATION

1. Full Council

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

2. Policy and Resources 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.

3. Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

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

THE GLOBAL ECONOMY

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. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US. Greece remains particularly vulnerable and continues to struggle to meet EZ targets for fiscal correction. Many commentators still view a Greek exit from the Euro as inevitable and there are concerns that austerity measures in Cyprus could also end up in forcing an exit. The question remains as to how much damage an exit by one country would do and whether contagion would spread to other countries. However, the longer a Greek exit is delayed, the less are likely to be the repercussions beyond Greece on other countries and on EU banks.

Sentiment in financial markets has improved considerably during 2013 as a result of firm Eurozone commitment to support struggling countries and to keep the Eurozone intact. However, the foundations to this current "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries like Greece and Spain which have unemployment rates of over 26% and unemployment among younger people of over 50%. The Italian political situation is also fraught with difficulties in getting a viable coalition which will implement an EZ imposed austerity programme and undertake overdue reforms to government and the economy.

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. Many house owners have therefore been helped to escape from negative equity and banks have also largely repaired their damaged balance sheets so that they can resume healthy levels of lending. All this portends well for a reasonable growth rate looking forward.

China. Concerns that Chinese growth could be heading downwards have been allayed by recent stronger statistics. There are still concerns around an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also increasing concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of

credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan. The initial euphoria generated by “Abenomics”, the huge QE operation instituted by the Japanese government to buy Japanese debt, has tempered as the follow through of measures to reform the financial system and introduce other economic reforms, appears to have stalled. However, at long last, Japan has seen strong growth of 4% in the first two quarters of 2013 which portends well for the hopes that Japan can escape from the bog of stagnation and help support world growth. The fiscal challenges though are huge; the gross debt to GDP ratio is about 245% in 2013 while the government is currently running an annual fiscal deficit of around 50% of total government expenditure. Within two years, the central bank will end up purchasing about Y190 trillion (£1,200 billion) of government debt. In addition, the population is ageing due to a low birth rate and will fall from 128m to 100m by 2050.

THE UK ECONOMY

Economic growth. 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. So very encouraging - yes, but, still a long way to go! However, growth is expected to be strong for the immediate future. 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.

Forward guidance. 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 (Labour Force Survey / ILO i.e. not the claimant count measure) 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 i.e. 7.7 % on the LFS / ILO measure. 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.

Credit conditions. While Bank Rate has remained unchanged at 0.5% and quantitative easing has remained unchanged at £375bn in 2013, the Funding for Lending Scheme (FLS), aimed at encouraging banks to expand lending to small and medium size enterprises, has been extended. The FLS certainly seems to be having a positive effect in terms of encouraging house purchases (though levels are still far below the pre-crisis level), FLS is also due to be bolstered by the second phase of Help to Buy aimed to support purchasing of

second hand properties, which is now due to start in October 2013. While there have been concerns that these schemes are creating a bubble in the housing market, the housing market remains weak outside of London and the south-east with a significant increase in house prices either being entirely absent or minimal. However, bank lending to small and medium enterprises continues to remain weak and inhibited by banks still repairing their balance sheets and anticipating tightening of regulatory requirements.

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.

AAA rating. The UK has lost its AAA rating from Fitch and Moody's but that caused little market reaction.

Capita Asset Services forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely 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.

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.

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.

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 upside 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.

UK Interest Rate Forecast

Bank Rate														
	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	-	-	-	-	-
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	-	-	-	-	-
Syr PWLB Rate														
	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	2.52%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
UBS	2.52%	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	2.52%	2.60%	2.60%	2.60%	2.60%	2.70%	2.80%	3.00%	3.20%	-	-	-	-	-
10yr PWLB Rate														
	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	3.55%	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
UBS	3.55%	3.70%	3.80%	3.90%	4.05%	4.05%	4.30%	4.55%	4.55%	-	-	-	-	-
Capital Economics	3.55%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	4.05%	-	-	-	-	-
25yr PWLB Rate														
	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	4.26%	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
UBS	4.26%	4.55%	4.55%	4.80%	4.80%	5.05%	5.05%	5.30%	5.30%	-	-	-	-	-
Capital Economics	4.26%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.45%	-	-	-	-	-
50yr PWLB Rate														
	NOW	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	4.22%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%
UBS	4.22%	4.45%	4.45%	4.70%	4.70%	4.90%	4.90%	5.05%	5.05%	-	-	-	-	-
Capital Economics	4.22%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.60%	-	-	-	-	-

- Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012