Sunderland City Council

Item No. 6

AUDIT AND GOVERNANCE COMMITTEE **6 February 2015**

TREASURY MANAGEMENT POLICY AND STRATEGY 2015/2016, INCLUDING PRUDENTIAL 'TREASURY MANAGEMENT' INDICATORS FOR 2015/2016 TO 2017/2018

Report of the Director of Finance

1. Purpose of the Report

1.1 To inform the Audit and Governance Committee on the Treasury Management Policy and Strategy (including both borrowing and investment strategies) proposed for 2015/2016 and to note the Prudential 'Treasury Management' Indicators for 2015/2016 to 2017/2018 and to provide comments to Cabinet and Council on the proposed policy and indicators where appropriate.

2. Treasury Management

2.1 Treasury Management is defined as "the management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.2 Statutory requirements

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential Indicators (including specific Treasury Management Indicators) for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. These are detailed in Appendix 1.

The Act also requires the Council to adopt a Treasury Management Policy Statement (Appendix 2) and to set out its Treasury Management Strategy. This comprises the Council's strategy for borrowing, and the Council's policies for managing its investments which gives priority to the security and liquidity of those investments (Appendix 3).

The Department of Communities and Local Government issued revised investment guidance which came into effect from 1 April 2010 and the Chartered Institute of Public Finance and Accountancy (CIPFA) updated its Treasury Management in the Public Services Code of Practice as a result.

2.3 CIPFA requirements

The Council continues to fully adopt and to re-affirm annually its adherence to the updated CIPFA Code of Practice on Treasury Management.

The primary requirements of the Code include:

1. The Council 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 (TMP's), 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.

   The content of the policy statement is detailed in Appendix 2 and the TMP's follow the recommendations contained in Sections 6 and 7 of the Code, subject only to minor variations where necessary to reflect the particular circumstances of the Council, but importantly these do not result in the Council deviating from the Code's key principles and requirements.

2. The Council will receive reports on 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, in the form prescribed in its TMP's.

3. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance, who acts in accordance with the organisation's Policy Statement, TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

4. The Council's Audit and Governance Committee is responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Treasury Management Strategy Statement for 2015/2016

2.4 The Treasury Management Strategy Statement comprises a Borrowing and an Investment Strategy. These set out the Council's policies for managing its borrowing and investments in 2015/2016.

2.5 There are however no major changes being proposed to the overall Treasury Management Strategy in 2015/2016 which maintains the careful and prudent approach adopted by the Council in previous years. Particular areas that inform the strategy include the extent of potential borrowing included in the Council's capital programme, the availability of borrowing, and the current and forecast world and UK economic positions, in particular forecasts relating to interest rates and security of investments.

2.6 The proposed Treasury Management Strategy Statement for 2015/2016 is set out in Appendix 3 and is based upon the views of the Director of Finance, supplemented with market data, market information and leading market forecasts provided by the Council's treasury adviser, Capita Asset Services.

2.7 The strategy is subject to regular review to ensure compliance to the agreed treasury management strategy and that the strategy adapts to changing financial markets as appropriate. It is pleasing to note that the Council's current average rate of borrowing at 3.35% is low in comparison with other local authorities whilst the current rate earned on investments at 0.76% is higher than the benchmark rate of 0.35%. The Council's TM performance is also benchmarked with the majority of local authorities and is highly ranked within the top quartiles for both its low average rate of borrowing and also for the rate of return achieved on its investments. Debt rescheduling undertaken by the Council in previous years has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. Market conditions are under constant review so that the Council can take a view on the optimum time to carry out further borrowing or debt rescheduling.

3. Recommendation

3.1 Committee is requested to:

- Note the proposed :
    - Annual Treasury Management Policy and Strategy for 2015/2016 (including specifically the Annual Borrowing and Investment Strategies) and,
    - Prudential 'Treasury Management' Indicators 2015/2016 to 2017/2018, and
- Provide any appropriate comments to Cabinet / Council on the proposals

Appendix 1

Prudential 'Treasury Management' Indicators 2015/2016 to 2017/2018

The indicators below relate to Treasury Management (all indicators relating to capital financing have been removed for clarity and can be found in the Capital Programme 2015/2016 and Treasury Management Policy and Strategy 2015/2016, including Prudential Indicators for 2015/2016 to 2017/2018 report to Cabinet – 11th February 2015).

P5 In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt (gross of investments) for the next three financial years. These limits must separately identify borrowing from other long-term liabilities such as PFI schemes and finance leases. The Council is asked to approve these limits and to delegate authority to the Director of Finance, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for the authority. Any such changes made will be reported to Cabinet and the Council at the next available meeting.

	Authorised Limit for External Debt			
	2014/2015 £000	**2015/2016 £000**	**2016/2017 £000**	**2017/2018 £000**
Borrowing	410,945	426,719	436,130	440,436
Other long term liabilities	29,178	27,508	26,509	26,289
Total	**440,123**	**454,227**	**462,639**	**466,725**

The Director of Finance confirms that the above authorised limits are consistent with the Authority's current commitments, existing plans and the proposals in this report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Director of Finance also confirms that they are based on the estimate of most likely, prudent, but not worst case scenario, with, in addition, sufficient headroom over and above this to allow for operational management, for example unusual cash movements and refinancing of all internal borrowing. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the Capital Financing Requirement and estimates of cash flow requirements for all purposes.

The Council also undertakes investment and borrowing on behalf of external bodies such as Tyne and Wear Fire and Rescue Authority. Treasury Management undertaken on behalf of other authorities is included in the Council's borrowing limits, however it is excluded when considering financing costs and when calculating net borrowing for the Council. A specific element of risk has also been taken into account for these bodies. The capital expenditure and borrowing of companies where the Council has an interest such as Siglion, Sunderland Care and Support Ltd, and Sunderland Live Ltd is not included within the Council's prudential indicators, however regard to the financial commitments and obligations to those bodies is taken into account when deciding whether borrowing is affordable.

In taking its decisions on the Revenue Budget and Capital Programme for 2015/2016, the Council is asked to note that the authorised limit determined for 2015/2016, (see P5 above), will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

P6 The Council is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit, but reflects directly the estimate of the most likely, prudent but not worst case scenario level, without the additional headroom included within the authorised limit to allow for example for unusual cash flow movements. It equates to the projected maximum external debt and represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. The Council is also requested to delegate authority to the Director of Finance, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, similar to the authorised limit set out in P5.

The operational boundary limit will be closely monitored and a report will be made to Cabinet if it is exceeded at any point in the financial year ahead. It is generally only expected that the actual debt outstanding will approach the operational boundary when all of the long-term borrowing has been undertaken for that particular year and will only be exceeded temporarily as a result of the timing of debt rescheduling.

	Operational Boundary for External Debt			
	2014/2015 £000	**2015/2016 £000**	**2016/2017£ 000**	**2017/2018 £000**
Borrowing	302,575	332,537	342,487	350,007
Other long term liabilities	29,178	27,508	26,509	26,289
Total	**331,753**	**360,045**	**368,996**	**376,296**

P7 The Council's actual external debt at 31st March 2014 was £238.344 million and was made up of actual borrowing of £210.267 million and actual other long term liabilities of £28.077 million

The Council includes an element for long-term liabilities relating to PFI schemes and finance leases in its calculation of the operational and authorised boundaries to allow further flexibility over future financing. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at any one point in time and allowance needs to be made for internal borrowing and cash flow variations.

P9 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The revised Code was adopted on 3rd March 2010 by full council and this is re-affirmed annually.

The objective of the Prudential Code is to provide a clear framework for local authority capital finance that will ensure for individual local authorities that:

(a) capital expenditure plans are affordable;

(b) all external borrowing and other long term liabilities are within prudent and sustainable levels;

(c) treasury management decisions are taken in accordance with professional good practice;

and that in taking decisions in relation to (a) to (c) above the local authority is

(d) accountable, by providing a clear and transparent framework.

Further, the framework established by the Code should be consistent with and support:

(e) local strategic planning;

(f) local asset management planning;

(g) proper option appraisal.

In exceptional circumstances the objective of the Code is to provide a framework that will demonstrate that there is a danger of not ensuring the above, so that the Authority can take timely remedial action.

CIPFA Treasury Management in the Public Services Code of Practice - Indicators 2015/2017 to 2017/2018

P10 It is recommended that the Council sets an upper limit on its fixed interest rate exposures of £245 million in 2015/2016, £255 million in 2016/2017 and £245 million in 2017/2018.

P11 It is further recommended that the Council sets an upper limit on its variable interest rate exposures of £60 million in 2015/2016, £48 million in 2016/2017 and £56 million in 2017/2018.

P12 It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period expressed as a percentage of total projected borrowing that is fixed rate at the start of the period:

	Upper limit	Lower limit
Under 12 months	50%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	80%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and within 50 years	100%	0%
over 50 years	100%	0%

P13 A maximum maturity limit of £75 million is set for each financial year (2015/2016, 2016/2017 and 2017/2018) for long-term investments, (those over 364 days), made by the authority. This gives additional flexibility to the Council in undertaking its Treasury Management function. Should the Council appoint any external fund managers during the year, these limits will be apportioned accordingly. Type of investments to be allowed are detailed in the Annual Investment Strategy (Appendix 3).

At present the Council has £21.420m of long-term investments. This is £16.400m for the value of share capital held in NIAL Holdings PLC (a 9.62% share), a £5.000m equity investment in Siglion (a 50% share) and the Council also holds £0.020m in government securities, other shares and unit trusts.

Appendix 2

Treasury Management Policy Statement

In line with CIPFA recommendations, on the 3rd March 2010 the Council adopted the following Treasury Management Policy Statement, which defines the policies and objectives of its treasury management activities:

- The Council defines its treasury management activities as: "The management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

- The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. 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.

- The Council 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.

The Council has an agreed Borrowing and Investment Strategy, the high level policies of which are as follows:

The basis of the agreed Borrowing Strategy is to:

- continuously monitor prevailing interest rates and forecasts;

- secure long-term funds to meet the Council's future borrowing requirement when market conditions are considered favourable;

- use a benchmark financing rate of 4.25% for long term borrowing (i.e. all borrowing for a period of one year or more);

- take advantage of debt rescheduling opportunities, as appropriate.

The general policy objective for the Council in considering potential investments is the prudent investment of its treasury balances.

- the Council's investment priorities in order of importance are:
    1) The security of its capital
    2) The liquidity of its investments and then
    3) The Council aims to achieve the optimum yield on its investments but this is commensurate with the proper levels of security and liquidity

- the Council has a detailed Lending List and criteria must be observed when placing funds – these are determined using expert TM advice, view of money market conditions and using detailed rating agency information as well as using our own market intelligence.

- Limits are also placed on the amounts that can be invested with individual and grouped financial institutions based on the Lending List and detailed criteria which is regularly reviewed.

The Council thus re-affirms its commitment to the Treasury Management Policy and Strategy Statement in 2015/2016 as it does every year.

Appendix 3

Treasury Management Strategy Statement for 2015/2016

1. Introduction

1.1 The Local Government Act 2003 and subsequent guidance requires the Council to set out its Treasury Management Strategy for Borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing both its borrowing and its investments, which gives priority to the security and liquidity of those investments.

The suggested strategy for 2015/2016 is set out below and is based upon the Director of Finance views on interest rates, supplemented with leading market forecasts and other financial data available and advice provided by the Council's treasury adviser, Capita Asset Services.

1.2 The treasury management strategy covers:

A. Borrowing Policy and Strategy

- treasury limits for 2015/2016 to 2017/2018
- current treasury management position
- prudential and treasury management Indicators for 2015/2016 to 2017/2018
- prospects for interest rates
- the borrowing strategy
- the borrowing requirement 2015/2016
- policy on borrowing in advance of need
- debt rescheduling

B. Annual Investment Policy and Strategy

- Investment policy and objectives
- the investment strategy
- investment types
- investments defined as capital expenditure
- investment limits
- provision for credit related losses
- creditworthiness policy
- monitoring of credit ratings
- past performance and current position
- outlook and proposed investment strategy
- external fund managers
- policy on use of external service providers

2. Borrowing Policy and Strategy

2.1 Treasury Limits for 2015/2016 to 2017/2018

It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council 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 Council 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 where relevant) 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 set, on a rolling basis, for the forthcoming financial year and two successive financial years and details can be found in Appendix 1(P5) of this report. The Council is asked to approve these limits and to delegate authority to the Director of Finance, within the total limit for any individual year, to action movement between the separately agreed limits for borrowing and other long term liabilities where this would be appropriate. Any such changes made will be reported to Cabinet and the Council at their next meetings following the change.

Also, the Council is requested to approve the Operational Boundary Limits (P6) which are included in the Prudential Indicators set out in Appendix 1. This operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified and the Council is also asked to delegate authority to the Director of Finance, within the total operational boundary for any individual year, to action movement between the separately agreed figures for borrowing and other long-term liabilities, in a similar fashion to the authorised limit.

2.2 Current Treasury Management Position

2.2.1 Interest Rates 2014/2015

The Bank of England Base Rate has remained at 0.50% since 5th March 2009 and is predicted by Capital Asset Services (the Council’s treasury advisors) to remain at that level until the fourth quarter of 2015 when it will begin to gradually rise until reaching 2.0% in March 2018. A number of analysts do not expect rates to begin to rise until 2016. The level of Consumer Price Inflation fell to 0.5% in December 2014 which is the lowest level since May 2000 and significantly below the Bank of England target of 2.0%. With a large decrease in the price of oil, inflation is likely to remain below 1% during 2015. Pressure to increase the Base Rate is low and in its November 2014 Inflation Report the Bank of England said that the actual path for monetary policy will be dependent on prevailing economic conditions and that when the bank rate does begin to rise it is expected to do so only gradually with the rate remaining below average historic levels for some time to come. As a consequence of this and banks access to alternative finance, investment returns are likely to remain low during 2015/2016 and beyond.

PWLB rates have been very volatile during 2014/2015 so far in response to both varying economic news and to world events. The Autumn Statement 2014 increased the UK growth forecast for 2014 from 2.7% to 3.0% but there are worries over growth prospects and the potential for deflation within the Eurozone. There are also concerns that growth in China is losing momentum and there are geopolitical concerns particularly over Ukraine and the Middle East. Uncertainty is expected to continue into the medium term.

The government announced in the March 2012 budget plans to introduce a 0.20% discount on PWLB loans under the prudential borrowing regime for those authorities that provided ‘improved information and transparency on their locally determined long-term borrowing and associated capital spending plans’ and who successfully applied and were eligible for the lower rate. The Council successfully applied to access PWLB loans at a discount of 0.20% and has been successful in extending its access to the PWLB certainty rate until 31st October 2015.

The following table shows the average PWLB rates for Quarters 1, 2 and 3.

2014/2015	**Qtr 1* (Apr - June) %**	**Qtr 2* (July - Sep) %**	**Qtr 3* (Oct – Dec) %**	**Qtr 4* (rates at 16th Jan 2015)**
7 days notice	**0.35**	**0.35**	**0.35**	**0.35**
1 year	**1.29***	**1.43***	**1.24***	**1.02***
5 year	**2.66***	**2.70***	**2.23***	**1.78***
10 year	**3.56***	**3.45***	**2.92***	**2.32***
25 year	**4.22***	**4.04***	**3.61***	**3.00***
50 year	**4.18***	**4.01***	**3.61***	**2.99***

*rates take account of the 0.2% discount to the PWLB rates available to eligible authorities that came into effect on 1st November 2012.

2.2.2 **Long Term Borrowing 2014/2015**

The Council’s strategy for 2014/2015 was to adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow and to respond to any changing circumstances to seek to secure benefit for the Council. A benchmark financing rate of 5.00% for long-term borrowing was set in the Treasury Management Policy and Strategy Statement for 2014/2015.

There was a large fall in PWLB borrowing rates in July, August and October as investors sought lower risk investment options following the conflict in Ukraine and more recently expectations of low inflation and economic growth that will require possible further financial support measures within the Eurozone. In line with discussions with the Council’s economic advisors it was decided to take advantage of these rates to support the Council’s Capital Programme requirements. As a result the Council has taken out £30 million of new borrowing during the financial year as these rates were considered opportune at each point in time. This will help maintain the Council’s long term borrowing interest rate at its comparatively low level and will benefit the Council’s revenue budget over the longer term. The new borrowing is summarised in the following table:

Duration	Date of the transaction	Start	Matures	Rate %	Loan Amount £m
50 years	08/08/2014	12/08/2014	12/08/2064	3.84	10.0
50 years	29/08/2014	02/09/2014	02/09/2064	3.72	10.0
50 years	16/10/2014	20/10/2014	20/10/2064	3.54	10.0

Since taking out this new borrowing, rates have fluctuated and lower inflation expectations have pushed rates downwards. At the time of preparing this report, PWLB interest rates have fallen to an all-time low as a result of turbulence in oil prices, low inflation and uncertainty in the Eurozone over the ECB's intention to implement quantitative easing measures and the outcome of the Greek election. The position is particularly volatile at the moment with further rate falls possible before reaching the bottom of the rate curve. The Treasury Management team continues to monitor PWLB rates closely to assess the value of possible further new borrowing in line with the Authority's future Capital Programme requirements.

The Borrowing Strategy for 2014/2015 made provision for debt rescheduling but due to the proactive approach taken by the Council in recent years, and because of the very low underlying rate of the Council's long-term debt, it would be difficult to refinance long-term loans at interest rates lower than those already in place. Rates have not been sufficiently favourable for rescheduling in 2014/2015 so far and the Treasury Management team will continue to monitor market conditions and secure early redemption if appropriate opportunities should arise.

The Council has seven market Lender's Option / Borrower's Option (LOBO) loans totalling £39.5 million. The lender has the option to alter the rate on these loans at set intervals and the Council can either accept the new rate or repay the loan without penalty. The following table shows the LOBO's that were subject to a potential rollover this financial year. No changes to loan rates were received and so these arrangements continue.

Roll Over Dates	**Lender**	**Amount £m**	**Rate %**	**Roll Over Periods**
21/04/2014 and 21/10/2014	Barclays	5.0	4.50	Every 6 months
10/06/2014	Barclays	9.5	4.37	every 3 years
27/01/2015	Dexia Credit Local	5.0	4.45	every 3 years
Total		**19.5**		

2.2.3 **Current Portfolio Position**

The Council's treasury portfolio position at 31st December 2014 comprised:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	157.9		
	Market (LOBO's)	39.5		
	Other	1.8	199.2	3.76
Variable Rate Funding	Temporary / Other		27.6	0.41
Total Borrowing			**226.8**	**3.35**
Total Investments	In House–short term*		**175.8**	**0.76**
Net Borrowing Position			**51.0**	

* The total investments figure includes monies invested on behalf of the North Eastern Local Enterprise Partnership for whom Sunderland City Council is the accountable body and ANEC which agreed with its member authorities that the council would invest its surplus funds

The Council currently has net borrowing of £51.0m which represents the difference between gross debt and total investments and is significantly lower that the Council's capital financing requirement (capital borrowing need). However this position is expected to change over the next few years as the Council has to manage its finances with significantly less government funding. This is likely to impact in the form of increased borrowing and reductions to reserves, with the result that the net borrowing position of the Council will increase.

There are a number of risks and benefits associated with having both a large amount of debt whilst at the same time having a considerable amount of investments.

Benefits of having a high level of investments are;

- liquidity risk – having a large amount of investments means that the Council is at less of a risk should money markets become restricted or borrowing less generally available, this mitigates against liquidity risk;
- interest is received on investments which helps the Council to address its Strategic Priorities;
- of greater importance is that the Council has greater freedom in the timing of its borrowing as it can afford to wait until the timing is right rather than be subject to the need to borrow at a time when interest rates are not advantageous.

Risks associated with holding a high level of investments are;

- the Counterparty risk – institutions cannot repay the Council investment placed with them;

- interest rate risk – the rate of interest earned on the investments will be less than that paid on debt, thus causing a loss to the Council.

The Council has mitigated these risks by having a risk averse Treasury Management Investment Strategy and by detailed monitoring of counterparties through its borrowing and investment strategies and treasury management working practices and procedures.

2.3 **Prudential and Treasury Management Indicators for 2015/2016 – 2017/2018**

Prudential and Treasury Indicators (as set out in Appendix 1) are a requirement of the CIPFA Prudential Code and are relevant for the purposes of setting an integrated treasury management strategy and to ensure that treasury management decisions are taken in accordance with good professional practice.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on 20th November 2002 and the latest revision to the Code in 2011 was adopted by the full Council on 3rd March 2012. The Council re-affirms its full adherence to the Code annually (as set out in Appendix 2).

2.4 **Prospects for Interest Rates**

The Council's treasury advisors are Capita Asset Services and part of their service is to assist the Council to formulate a view on interest rates. A number of current City forecasts for short term (Bank Rate) and longer fixed interest rates are set out in Appendix 4. The following gives the Capita Asset Services Bank Rate forecast for the current and next 3 financial years.

- 2014/2015 0.50%
- 2015/2016 0.50% - 0.75%
- 2016/2017 0.75% - 1.25%
- 2017/2018 1.25% - 2.00%

There are downside risks to these forecasts (that the increase in Bank Rate is later than predicted) if inflation remains below the 2% target set by Government and economic growth is weaker than expected. However it is clear that interest rates will remain at historically low levels into the medium term which will keep investment returns at low levels. A detailed view of the current economic background is contained within Appendix 5 to this report. The position will be closely monitored to ensure the Council takes appropriate action as necessary under either scenario.

2.5 **Borrowing Strategy**

The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This involves both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

2.6 **Borrowing Requirement 2015/2016**

The Council's potential borrowing requirement is as follows**:**

		2015/16 £m	2016/17 £m	2017/18 £m
1.	Capital Borrowing (potential)	43.7	35.3	12.2
2.	Replacement borrowing (PWLB)	0.0	0.0	4.0
3.	Replacement borrowing (Other)	1.3	0.0	0.0
4.	Replacement LOBO (potential)	20.0	10.0	19.5
TOTAL		**65.0**	**45.3**	**35.7**

2.6.1 **Borrowing rates**

The Capita Asset Services forecast in respect of interest rates for loans charged by the PWLB is as follows: -

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

A more detailed forecast from Capita Asset Services is included in Appendix 4.

The main sensitivities of the forecast are likely to be;

- if it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the rate to US tapering of asset purchases, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate borrowing will be undertaken whilst interest rates are still lower than they will be in the next few years.
- if it were felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around a relapse into recession or, a risk of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

Council officers, in conjunction with the Council's treasury advisers, monitor both the prevailing interest rates and the market forecasts. The Director of Finance, taking into account the advice of the Council's treasury adviser considers a benchmark financing rate of 4.25% for any further long-term borrowing for 2015/2016 to be appropriate.

It is possible that a Municipal Bonds Agency, currently being set up by the Local Government Association, will be offering bonds to local authorities in 2015/2016. The rates offered by the new Agency will be assessed and use made of this new source of funding where it is considered advantageous.

Consideration will be also given to other options, including utilising some investment balances to fund the borrowing requirement in 2015/2016. This policy has served the Council well over the last few years as investment returns continue to be low. As a result the Council is currently maintaining a large under-borrowed position. This position will be carefully reviewed to avoid incurring higher borrowing costs over the long term whilst ensuring that financing is available to support capital expenditure plans. The need to adapt to changing circumstances and revisions to profiling of capital expenditure is required, and flexibility needs to be retained to adapt to any changes that may occur.

The Director of Finance, taking advice from the Council's treasury advisers will continue to monitor rates closely, and whilst implementing the borrowing strategy, will adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow, wherever possible.

2.7 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be assessed within the relevant Capital Financing Requirement estimates, and will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance of activity will be subject to prior appraisal and borrowing undertaken will be reported to Cabinet as part of the agreed treasury management reporting arrangements.

2.8 Debt Rescheduling

The reasons for any rescheduling of debt will include:

- the generation of cash savings at minimum risk;
- in order to help fulfil the Treasury Management Strategy; and
- in order to enhance the balance of the long-term portfolio (by amending the maturity profile and/or the balance of volatility).

In previous years, debt rescheduling has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. However in 2007 the PWLB introduced a spread between the rates applied to new borrowing and repayment of debt which was compounded in 2010 by a considerable further widening of the difference between new borrowing and repayment rates and it has meant that PWLB debt restructuring is much less attractive than it was before both of these measures were introduced. Consideration will also be given to other options where interest savings may be achievable by using LOBO (Lenders Option Borrowers Option) loans, and / or other market loans, in rescheduling exercises rather than solely using PWLB borrowing as the source of replacement financing but this would only be the case where this would represent best value to the Council.

The latest interest rate projections for 2015/2016 show short term borrowing rates will be cheaper than longer term rates and as such there may be potential for some opportunities to generate savings by switching from long term debt to short-term debt. These potential savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

The Council is keeping a watching brief on market conditions in order to secure further debt rescheduling when, and if, appropriate opportunities arise. The timing of all borrowing and investment decisions inevitably includes an element of risk, as those decisions are based upon expectations of future interest rates. The policy to date has been very firmly one of risk spread and this prudent approach will be continued.

Any rescheduling undertaken will be reported to Cabinet, as part of the agreed treasury management reporting arrangements.

3. Annual Investment Policy and Strategy

3.1 Investment Policy and Objectives

When considering its investment policy and objectives, the Council has taken regard to the Department of Communities and Local Government's (CLG) Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The Council's investment objectives are: -

(a) the security of capital, and
(b) the liquidity of its investments.

The Council also aims to achieve the optimum return on its investments but this is commensurate with proper levels of security and liquidity.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of risk. The risk appetite of the Council is regarded as 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 Council will not engage in such activity.

3.2 Investment Strategy

This Strategy sets out:

- the guidelines for choosing and placing investments;
- the maximum periods for which funds may be prudently committed in each class of investment;
- the amount or percentage limit to be invested in each class of investment;
- specified investments that the Council will use;
- non-specified investments that the Council will use, clarifying the greater risk implications, identifying the general type of investment that may be used and a limit to the overall amounts of various categories that can be held at any time.

3.3 Investment Types

The Council is allowed to invest in two types of investment, namely Specified Investments and Non-specified Investments.

Specified Investments are sterling investments that are for a period of not more than one-year maturity, or those which they could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are placed with high rated counterparties and are considered low risk assets where the possibility of loss of principal or investment income is small. Within these bodies and in accordance with the Code, the Council has set additional criteria to limit the time and amount of monies that will be invested with these bodies.

Non-specified Investments are any investments which are not classified as specified investments. As the Council only uses investment grade high credit rated counterparties this means in effect that any investments placed with those counterparties for a period over one year will be classed as Non-specified Investments.

Any non-specified investment by the Council that is classed as capital expenditure (see 3.4 below) will be subject to a full appraisal and reported to Cabinet for approval.

The type of investments to be used by the in-house team will be limited to Certificates of Deposit, fixed term deposits, interest bearing accounts, Money Market Funds, Government debt instruments, floating rate notes, corporate bonds, municipal / local authority bonds and gilt edged securities and will follow the criteria as set out in Appendix 6.

3.4 Investments Defined as Capital Expenditure

The acquisition of share capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003 and as such acquisition of share capital will be an application of capital resources. Such investments have to be funded out of capital or revenue resources and are classified as ‘non-specified investments’.

A loan or grant by this Council to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by the Council. It is therefore important for the Council to clearly identify if the loan has been made for policy reasons or if it is an investment for treasury management purposes. Only the latter will be governed by the framework set by the Council for ‘specified’ and ‘non-specified’ investments.

3.5 **Investment Limits**

One of the recommendations of the Code is that local authorities should set limits for the amounts of investments that can be placed with institutions by country, sector and group. These limits are applied in the Council's Counterparty criteria set out in Appendix 6.

The minimum amount of overall investments that the Council will hold in short-term investments (less than one year) is £50 million. As the Council has decided to restrict most of its investments to term deposits, it will maintain liquidity by having a minimum of 30% of these short-term investments maturing within 6 months.

A maximum limit of £75 million is to be set for in-house non-specified investments over 364 days up to a maximum period of 2 years. This amount has been calculated by reference to the Council’s cash flows, including the potential use of earmarked reserves. The Director of Finance will monitor long-term investment rates and identify any investment opportunities if market conditions change.

3.6 **Provisions for Credit Related Losses**

If any of the Council’s investments appear at risk of loss due to default, (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates), then the Council will make revenue provision of an appropriate amount in accordance with proper accounting practice or any prevailing government regulations, if applicable. This position has not occurred and the Council mitigates this risk with its prudent investment policy.

3.7 **Creditworthiness policy**

Following the financial crisis of 2008 it was recognised that investors, who largely remained unaffected through this period, should share the burden in future by making them forfeit part of their investment to “bail in” a bank before taxpayers are called upon.

The main rating agencies (Fitch, Moody’s and Standard & Poor’s) have, through much of the financial crisis, provided some institutions with a ratings “uplift” due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these “uplifts”. The agencies are expected to remove implied sovereign support from financial institution ratings based in the EU at some stage ahead of January 2016 (when bail-in measures are finally enacted). The timing and extent of changes is still not clear but immediate changes to the credit methodology used are required.

In the UK the Government is expected to end their bank guarantee scheme. This will mean investments that council's make with UK financial institutions would not be guaranteed by the Government and that if the financial institution encountered financial problems then the Council would become an unsecured depositor. It is important to stress that the regulatory changes that are being made in the UK and the rest of Europe are designed to make the financial system sounder and their implementation will not suddenly weaken institutions. In December 2014 the Bank of England published the results of a stress test for major UK financial institutions. The test assessed major UK lenders' ability to withstand another financial crisis and it built on similar health checks by the European Banking Authority. Only one UK institution (the Co-op) failed the test although another two were assessed as being at risk in the event of a "severe economic downturn". Mark Carney the Governor of the Bank of England said that the results show that the banking system is "significantly more resilient" and that the "growing confidence in the system is merited". All financial institutions are continuing to build capital reserves further going forward.

The rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become unnecessary. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

As with previous practice, ratings will not be the sole determinant of the quality of an institution and the Council will 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 Council will engage with its advisors to monitor market pricing such as "credit default swaps" and overlay that information on top of the credit ratings provided.

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.

In summary the UK financial institutions have stregthened their Balance Sheets to better accommodate the impact of another financial crisis. As a result, government intervention would become limited if at all and Bail-In arrangements would apply if banks were to fail. This increases the risk of depositors but only to the extent the institution can not withstand the total losses.

Set out in Appendix 6 is the detailed criteria that will be used, subject to approval, in determining the level of investments that can be invested with each counterparty or institution. Where a counterparty is rated differently by any of the 3 rating agencies, the lowest rating will be used to determine the level of investment. If the Council's own banker, National Westminster Bank plc should fail to meet the minimum credit criteria to allow investments from the Council then balances will be minimized as far as possible.

3.8 **Monitoring of Credit Ratings**

- All credit ratings are monitored on a daily basis. The Council has access to all three credit ratings agencies and is alerted to changes through its use of Capita Asset Services counterparty service.
- If a counterparty's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the Council will cease to place funds with that counterparty.
- If a counterparty's rating is downgraded with the result that, their rating is still sufficient for the counterparty to remain on the Approved Lending List, then the counterparty's authorised investment limit will be reviewed accordingly. A downgraded credit rating may result in the lowering of the counterparty's investment limit and vice versa.

Should the UK Government AA+ sovereign rating be withdrawn the Council's Investment Strategy and Lending List criteria will be reviewed and any changes necessary will be reported to Cabinet.

3.9 **Past Performance and Current Position**

During 2014/2015 the Council did not employ any external fund managers, all funds being managed by the in-house team. The performance of the fund by the in-house team is shown below and compares this with the relevant benchmarks and performance from the previous year:

Return	2013/14 Benchmark %	2013/14 Return %	To date 2014/15 Benchmark %	To date 2014/15 %
Council	1.03	0.35	0.76	0.35

During 2015/2016 the Council will continue to review the optimum arrangements for the investment of its funds whilst fully observing the investment strategy in place. The Council uses the 7 day London Interbank Bid (LIBID) rate as a benchmark for its investments. The performance of the Council compared well with other local authorities and is in the top quartile.

3.10 Outlook and Proposed Investment Strategy

Based on its cash flow forecasts, the Council anticipates its fund balances in 2015/2016 are likely to range between £80 million and £200 million. This represents a cautious approach and provides for funding being received in excess of the level budgeted for, and also for unexpected and unplanned levels of capital underspending in the year or reprofiling of spend into future years. In 2015/2016, with short-term interest rates forecast to be materially below long-term rates, it is possible that some investment balances will continue to be used to fund some long-term borrowing or used for debt rescheduling. Such funding is wholly dependent upon market conditions and will be assessed and reported to Cabinet if and when the appropriate conditions arise.

The Council is not committed to any investments, which are due to commence in 2015/2016, (i.e. it has not agreed any forward deals).

Activities likely to have a significant effect on investment balances are:

- Capital expenditure during the financial year, (dependent upon timing), will affect cash flow and short term investment balances;
- Any reprofiling of capital expenditure from, and to, other financial years will also affect cash flow, (no reprofiling has been taken into account in current estimates);
- Any unexpected capital receipts or other income;
- Timing of new long-term borrowing to fund capital expenditure;
- Possible funding of long-term borrowing from investment balances (dependent upon appropriate market conditions).

The Director of Finance, in conjunction with the Council's treasury adviser Capita Asset Services, and taking into account the minimum amount to be maintained in short-term investments, will continue to monitor investment rates closely and to identify any appropriate investment opportunities that may arise.

It is proposed that delegated authority continues for the Director of Finance, in consultation with the Cabinet Portfolio holder for Resources, to vary the Lending List Criteria and Lending List itself should circumstances dictate, on the basis that changes be reported to Cabinet retrospectively, in accordance with normal treasury management reporting procedures.

3.11 External fund managers

At present the Council does not employ any external fund managers.

Should the Council appoint any external fund managers in the future, they will have to agree to strict investment limits and investment criteria. These will be reported to Cabinet for agreement prior to any external fund manager being appointed.

3.12 **Policy on the use of external service providers**

The Council uses Capita Asset Services as its external treasury management advisers. The Council recognises that responsibility for treasury management decisions remain with the Council at all times and will ensure that undue reliance is not placed upon our 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 Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review.

4. Scheme of delegation

4.1 The Treasury Management Strategy Statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy (TMS) is approved annually by the full Council and receives, as a minimum, a mid-year TMS report and an annual Treasury Management outturn report for the previous year by no later than the 30th September of the following year. In addition quarterly reports are made to Cabinet and the Audit and Governance Committee and monitoring reports are reviewed by members in both executive and scrutiny functions respectively. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The Council has the following reporting arrangements in place in accordance with the requirements of the Code: -

Area of Responsibility	**Council/ Committee/ Officer**	**Frequency**
Treasury Management Policy Statement (revised)	Full Council	Reaffirmed annually and updated as appropriate
Treasury Management Strategy / Annual Investment Strategy	Full Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy – mid year report	Full Council	Mid year
Treasury Management Strategy / Annual Investment Strategy – updates or revisions at other times	Full Council	As appropriate
Annual Treasury Management Outturn Report	Full Council	Annually by 30/9 after the end of the financial year

Area of Responsibility	Council/ Committee/ Officer	Frequency
Treasury Management Monitoring Reports	Director of Finance	Monthly
Treasury Management Practices	Director of Finance	Annually
Scrutiny of Treasury Management Strategy	Cabinet / Audit and Governance Committee	Annually before Full Council
Scrutiny of Treasury Management Performance	Cabinet / Audit and Governance Committee	Quarterly

5. The Treasury Management Role of the Section 151 Officer

5.1 The Director of Finance is the Council's Section 151 Officer and has specific delegated responsibility in the Council's Constitution tomanage the borrowing, financing, and investment requirements of the Council in accordance with the Treasury Management Policy agreed by the Council. This includes;

- 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.

Appendix 4

Interest Rate Forecasts

The data set out overleaf shows a variety of forecasts published by Capita Asset Services, Capital Economics (an independent forecasting consultancy) and UBS (which represents summarised figures drawn from the population of all major City banks and academic institutions).

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. Interest Rate Forecasts

Capita Asset Services Interest Rate View													
	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.10%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	0.70%	0.80%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.30%
12 Month LIBID	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yr PWLB Rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB Rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
Capital Economics	2.20%	2.50%	2.70%	3.00%	3.10%	3.20%	3.30%	3.40%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
Capital Economics	2.80%	3.05%	3.30%	3.55%	3.60%	3.65%	3.70%	3.80%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.25%	3.45%	3.65%	3.85%	3.95%	4.05%	4.15%	4.25%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.30%	3.50%	3.70%	3.90%	4.00%	4.10%	4.20%	4.30%	-	-	-	-	-

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

2. Survey of Economic Forecasts

HM Treasury December 2014

The current Q4 2014 and 2015 base rate forecasts are based from samples of both City and non-City forecasters included in the HM Treasury December 2014 report.

	Quarter ended		annual average Bank Rate		
BANK RATE FORECASTS	**Q4 2014**	**Q4 2015**	**ave. 2016**	**ave. 2017**	**ave. 2018**
Average	0.50%	0.90%	1.50%	2.20%	2.60%
Highest	0.80%	2.00%	2.00%	3.00%	3.70%
Lowest	0.50%	0.50%	0.90%	0.90%	1.10%

Economic Background **Appendix 5**

1.1 Global Economy Update

The Eurozone

The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In December, the inflation rate fell further, to reach a low of -0.2%. This is an average for all EZ countries and is the first time that the Eurozone has experienced deflation since the financial crisis in 2009. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. It has not embarked yet on full quantitative easing (purchase of sovereign debt) although ECB president Mario Draghi's has indicated that this could commence soon and it appears likely that full quantitative easing will begin in early 2015.

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

The current situation in Greece is still volatile**.** The general election on 25 January 2015 is likely to bring a political party to power which is 'anti-austerity'. If this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate resources to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti-austerity political parties throughout the EU is much more difficult to quantify. 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 which have high unemployment rates. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti-austerity policies. Any loss of market confidence in either of the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB.

USA
The Federal Reserve ended its monthly asset purchases in October 2014, signalling confidence the US economic recovery would remain on track. First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in Q2 to 4.6% and increased again in Q3 to 5.0% which is the fastest rate of growth recorded since 2003. Annual growth during 2015 is predicted to be around 3%.

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

China
Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for a number of years. There are also concerns that the Chinese leadership have only started to address an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan
Recession in the Japanese economy is causing considerable concern as an increase in sales tax from 5% to 8% in April 2014 has suppressed consumer expenditure and growth. The tax increase was legislated by the previous government in 2012 to curb Japan's public debt, which is the highest among developed nations. In Q3 growth was -0.5% and -1.9% over the previous year. In addition, the population is ageing due to a low birth rate and is estimated to fall from 128m to 100m by 2050.

1.2 UK economy

Economic growth
Recovery is stronger in the UK than the rest of Europe with UK GDP growing for 7 successive quarters. There has been strong UK GDP quarterly growth of 0.7%, 0.9% and 0.7% in quarters 1,2 and 3 in 2014 (annual rate 2.6% in Q3) and the Autumn Statement 2014 increased the growth forecast for 2014 from

2.7% to 3.0% and for 2015 from 2.3% to 2.4%. Forward surveys for the services and construction sectors are encouraging although there has been a weakening in the future trend rate of growth for the manufacturing sector and UK growth is fragile and strongly linked to worldwide events. For the recovery to become more balanced and sustainable in the longer term it needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly manufactured goods, both of which need to substantially improve on their recent performance.

Forward guidance

The overall strong growth has resulted in unemployment falling faster than expected reaching 5.8% in November 2014. Total employment levels are also at the highest since records began in 1971 with 30.8m employed. These unemployment levels are much lower than the initial threshold of 7%, set by the Monetary Policy Committee (MPC) in August 2013, before it said it would consider any increases to the Bank Rate. The MPC has subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has been at low levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Inflation

Inflation (CPI) has fallen sharply during 2014 after being consistently above the MPC's 2% target between December 2009 and December 2013. Inflation fell to 0.5% in December 2014, its lowest level since 2000. The Bank of England do not expect inflation to reach the target rate of 2% for 3 years and have warned it could remain below 1% for the next 6 months. Overall, markets are expecting that the MPC will be cautious in raising the Bank Base Rate as it will want to protect heavily indebted consumers from too early an increase at a time when inflationary pressures are also weak. A first increase in Bank Rate is expected in Q4 2015 with increases after that expected to be at a slow pace with rates remaining at lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

Government Debt

Debt is still increasing and at the end of October 2014 borrowing, at £64.1bn, was £3.6bn higher than at the same period in 2013. The Chancellor announced in the 2014 Autumn Statement that the March 2014 borrowing targets would not be met and the borrowing target for 2014/2015 was increased from £86.4bn to £91.3bn with the 2015/2016 target being increased from £68.3bn to £75.9bn. The deficit budget is not expected to be in surplus until 2018/2019.

1.3 Economic Forecast

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Over time, an increase in investor confidence in world economic recovery is also likely to compound this effect as recovery will further encourage investors to switch from bonds to equities.
The overall balance of risks to economic recovery in the UK is currently evenly weighted. However it remains exposed to vulnerabilities in a number of key areas.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has taken sufficient action that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed resolution of the debt crisis where EZ institutions and governments eventually do what is necessary. Under this assumed scenario, growth within the EZ will be tepid for the next couple of years and some EZ countries experiencing low or negative growth, will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and/or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is difficult to forecast whether any individual country will lose such confidence, or when, and so will precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the large countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Downside risks currently include:

- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.
- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven cash flows
- Fears generated by the potential impact of Ebola around the world

- UK strong economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market and is weaker than anticipated .
- A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth beyond 2014.
- Weak growth or recession in the UK's main trading partner - the EU, inhibiting economic recovery in the UK.
- A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.
- A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.
- Recapitalisation of European banks requiring considerable government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan

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

- A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds into equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government
- ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.
- The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.

Lending List Criteria **Appendix 6**

Counterparty Criteria
The Council takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisers.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

Fitch / S&P's Long Term Rating	**Fitch Short Term Rating**	**S&P's Short Term Rating**	**Moody's Long Term Rating**	**Moody's Short Term Rating**	**Maximum Deposit £m**	**Maximum Duration**
AAA	F1+	A1+	Aaa	P-1	120	2 Years
AA+	F1+	A1+	Aa1	P-1	100	2 Years
AA	F1+	A1+	Aa2	P-1	80	2 Years
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	75	2 Years
A+	F1	A-1	A1	P-1	70	364 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	65	364 days
A-	F1 / F2	A-2	A3	P-1 / P-2	50	364 days
Local Authorities (limit for each local authority)					30	2 years
UK Government (including debt management office, gilts and treasury bills)					350	2 years
Money Market Funds Maximum amount to be invested in Money Market Funds is £120m with a maximum of £50m in any one fund.					120	Liquid Deposits
Local Authority controlled companies (# duration limited to 20 years in accordance with Capital Regulations)					20	# 20 years

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AA+ will be applied to that institution to determine the amount the Council can place with that institution for a maximum period of 2 years.

Where any banks / building societies are part of the UK Government's Credit Guarantee scheme (marked with * in the Approved Lending List), these counterparties will have an A+ rating applied to them thus giving them a credit limit of £70 million for a maximum period of 364 days.

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above, these new limits are as follows:

Country Limit
It is proposed that only countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £100 million which can be invested in other countries provided they meet the above criteria. A separate limit of £350m will be applied to the United Kingdom and is based on the fact that the government has shown that it has been willing to take action to protect the UK banking system.

Country	Limit £m
UK	350
Non-UK	100

Sector Limit
The Code recommends a limit be set for each sector in which the Council can place investments. These limits are set out below

Sector	Limit £m
Central Government	350
Local Government	350
UK Banks	350
Money Market Funds	120
UK Building Societies	100
Foreign Banks	100

Group Limit
Where institutions are part of a group of companies e.g. Lloyds Banking Group, Santander and RBS, then total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. The government rating will apply provided that:

- the government's guarantee scheme is still in place;
- the UK continues to have a sovereign credit rating of AA+; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix 7.

Appendix 7

Approved Lending List

	Fitch		**Moody's**		**Standard & Poor's**			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
UK	AA+	-	Aa1	-	AAA	-	350	2 years
Lloyds Banking Group (see Note 1)							**Group Limit 100**	
Lloyds Banking Group plc	A	F1	A2	-	A-	A-2	100	2 years
Lloyds Bank Plc	A	F1	A1	P-1	A	A-1	100	2 years
Bank of Scotland Plc	A	F1	A1	P-1	A	A-1	100	2 years
Royal Bank of Scotland Group (See Note 1)							**Group Limit 100**	
Royal Bank of Scotland Group plc	A	F1	Baa2	P-2	BBB+	A-2	100	2 years
The Royal Bank of Scotland Plc	A	F1	Baa1	P-2	A-	A-2	100	2 years
National Westminster Bank Plc	A	F1	Baa1	P-2	A-	A-2	100	2 years
Ulster Bank Ltd	A-	F1	Baa3	P-3	BBB+	A-2	100	2 years
Santander Group *							**Group Limit 70**	
Santander UK plc	A	F1	A2	P-1	A	A-1	70	364 days
Cater Allen	-	-	-	-	-	-	70	364 days
Barclays Bank plc *	A	F1	A2	P-1	A	A-1	70	364 days
HSBC Bank plc *	AA-	F1+	Aa3	P-1	AA-	A-1+	70	364 days
Nationwide BS *	A	F1	A2	P-1	A	A-1	70	364 days
Standard Chartered Bank *	AA-	F1+	A1	P-1	A+	A-1	70	364 days
Clydesdale Bank / Yorkshire Bank **/***	A	F1	Baa2	P-2	BBB+	A-2	0	
Co-Operative Bank Plc	B	B	Caa2	NP	-	-	0	
Top Building Societies (by asset value)								

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Nationwide BS (see above)								
Yorkshire BS ***	A-	F1	Baa1	P-2	-	-	0	
Coventry BS	A	F1	A3	P-2	-	-	50	364 days
Skipton BS ***	BBB	F2	Baa3	P-3	-	-	0	
Leeds BS	A-	F1	A3	P-2	-	-	50	364 days
West Bromwich BS ***	-	-	B2	NP	-	-	0	
Principality BS ***	BBB+	F2	Baa3	P-3	-	-	0	
Newcastle BS ***	BB+	B	-	-	-	-	0	
Nottingham BS ***	-	-	Baa2	P-2	-	-	0	
Money Market Funds							120	Liquid
Prime Rate Stirling Liquidity	AAA		Aaa		AAA		50	Liquid
Insight Liquidity Fund	AAA		-		AAA		50	Liquid
Ignis Sterling Liquidity	AAA		-		AAA		50	Liquid
Deutsche Managed Sterling Fund	-		Aaa		AAA		50	Liquid
Foreign Banks have a combined total limit of £100m								
Australia	AAA		Aaa		AAA		100	364 days
National Australia Bank	AA-	F1+	Aa2	P-1	AA-	A-1+	75	364 days
Australia and New Zealand Banking Group Ltd	AA-	F1+	Aa2	P-1	AA-	A-1+	75	364 days
Commonwealth Bank of Australia	AA-	F1+	Aa2	P-1	AA-	A-1+	75	364 days
Westpac Banking Corporation	AA-	F1+	Aa2	P-1	AA-	A-1+	75	364 days
Canada	AAA		Aaa		AAA		100	364 days
Bank of Nova Scotia	AA-	F1+	Aa2	P-1	A+	A-1	70	364 days
Royal Bank of Canada	AA	F1+	Aa3	P-1	AA-	A-1+	75	364 days
Toronto Dominion Bank	AA-	F1+	Aa1	P-1	AA-	A-1+	75	364 days

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Finland	AAA		Aaa		AA+		100	364 days
Nordea Bank Finland plc	AA-	F1+	Aa3	P-1	AA-	A-1+	75	364 days
Pohjola Bank	A+	F1	Aa3	P-1	AA-	A-1+	70	364 days
Germany	AAA		Aaa		AA+		100	364 days
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	A+	F1+	A1	P-1	AA-	A-1+	70	364 days
Landwirtschaftliche Rentenbank	AAA	F1+	Aaa	P-1	AAA	A-1+	75	364 days
NRW Bank	AAA	F1+	Aa1	P-1	AA-	A-1+	75	364 days
Hong Kong	AA+		Aa1		AAA		100	364 days
The Hong Kong and Shanghai Banking Corporation Ltd	AA-	F1+	Aa2	P-1	AA-	A-1+	75	364 days
Luxembourg	AAA		Aaa		AAA		100	364 days
Banque et Caisse d'Epargne de l'Etat	-	-	Aa1	P-1	AA+	A-1+	100	364 days
Clearstream Banking	AA	F1+	-	-	AA	A-1+	80	364 days
Netherlands	AAA		Aaa		AA+		100	364 days
Bank Nederlandse Gemeenten	AAA	F1+	Aaa	P-1	AA+	A-1+	80	364 days
Cooperatieve Centrale Raiffeisen Boerenleenbank BA (Rabobank Nederland)	AA-	F1+	Aa2	P-1	A+	A-1	70	364 days
Nederlandse Waterschapsbank N.V	-	-	Aaa	P	AA+	A-1+	80	364 days
Singapore	AAA		Aaa		AAA		100	364 days
DBS Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	364 days
Oversea Chinese Banking Corporation Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	364 days
United Overseas Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	364 days
Sweden	AAA		Aaa		AAA		100	364 days

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Nordea Bank AB	AA-	F1+	Aa3	P-1	AA-	A-1+	75	364 days
Svenska Handelsbanken AB	AA-	F1+	Aa3	P-1	AA-	A-1+	75	364 days
USA	AAA		Aaa		AA+		100	364 days
Bank of New York Mellon	AA-	F1+	Aa2	P-1	AA-	A-1+	75	364 days
HSBC Bank USA, N.A.	AA-	F1+	A1	P-1	AA-	A-1+	70	364 days
JPMorgan Chase Bank NA	A+	F1	Aa3	P-1	A+	A-1	70	364 days
Northern Trust Company	AA-	F1+	A1	P-1	AA-	A-1+	70	364 days
State Street Bank and Trust Company	AA-	F1+	Aa3	P-1	AA-	A-1+	75	364 days
U.S. Bancorp	AA-	F1+	A1	P-1	A+	A-1	70	364 days
Wells Fargo Bank NA	AA-	F1+	Aa3	P-1	AA-	A-1+	75	364 days

Notes

Note 1 **Nationalised / Part Nationalised**
The counterparties in this section will have the UK Government's AA+ rating applied to them thus giving them a credit limit of £100m.

* Banks / Building Societies which are part of the UK Government's Credit Guarantee scheme
The counterparties in this section will have an A+ rating applied to them thus giving them a credit limit of £70 million

** The Clydesdale Bank (under the UK section) is owned by National Australia Bank

*** These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the FSA is classed as a UK bank for the purposes of the Approved Lending List.