Sunderland City Council

Item No. 4

AUDIT AND GOVERNANCE COMMITTEE **5 February 2016**

TREASURY MANAGEMENT POLICY AND STRATEGY 2016/2017, INCLUDING PRUDENTIAL 'TREASURY MANAGEMENT' INDICATORS FOR 2016/2017 TO 2018/2019

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 2016/2017 and to note the Prudential 'Treasury Management' Indicators for 2016/2017 to 2018/2019 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, and 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 2016/2017

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 2016/2017.

2.5 There are however no major changes being proposed to the overall Treasury Management Strategy in 2016/2017 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 2016/2017 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 3.51% is low in comparison with other local authorities whilst the current rate earned on investments at 0.91% is higher than the benchmark rate of 0.36%. 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 2016/2017 (including specifically the Annual Borrowing and Investment Strategies) and,
    - Prudential 'Treasury Management' Indicators 2016/2017 to 2018/2019, and
- Provide any appropriate comments to Cabinet / Council on the proposals.

Appendix 1

Prudential 'Treasury Management' Indicators 2016/2017 to 2018/2019

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 2016/2017 and Treasury Management Policy and Strategy 2016/2017, including Prudential Indicators for 2016/2017 to 2018/2019 report to Cabinet – 10th February 2016).

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			
	2015/2016 £000	**2016/2017 £000**	**2017/2018 £000**	**2018/2019 £000**
Borrowing	426,749	453,349	457,321	458,705
Other long term liabilities	89,659	88,553	84,581	80,338
Total	**516,408**	**541,902**	**541,902**	**539,043**

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 2016/2017, the Council is asked to note that the authorised limit determined for 2016/2017 (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			
	2015/2016	**2016/2017**	**2017/2018**	**2018/2019**
	£000	**£000**	**£000**	**£000**
Borrowing	332,537	370,400	374,372	378,321
Other long term liabilities	89,659	88,553	84,581	80,338
Total	**422,196**	**458,953**	**458,953**	**458,659**

P7 The Council's actual external debt at 31st March 2015 was £339.943 million and was made up of actual borrowing of £249.208 million and actual other long term liabilities of £90.735 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 2016/2017 to 2018/2019

P10 It is recommended that the Council sets an upper limit on its fixed interest rate exposures of £330 million in 2016/2017, £320 million in 2017/2018 and £320 million in 2018/2019.

P11 It is further recommended that the Council sets an upper limit on its variable interest rate exposures of £48 million in 2016/2017, £56 million in 2017/2018 and £54 million in 2018/2019.

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 which is set out on the next page:

	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 (2016/2017, 2017/2018 and 2018/2019) for long-term investments (those over 364 days), made by the Council. 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. The type of investments to be allowed are detailed in the Annual Investment Strategy (Appendix 3).

At present the Council has £21.414 million of long-term investments. This is £16.400 million for the value of share capital held in NIAL Holdings PLC (a 9.62% share), a £5.000 million equity investment in Siglion (a 50% share) and the Council also holds £0.014 million in 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 4.00% 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 which 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 2016/2017 as it does every year.

Appendix 3

Treasury Management Strategy Statement for 2016/2017

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 2016/2017 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 2016/2017 to 2018/2019
- current treasury management position
- prudential and treasury management Indicators for 2016/2017 to 2018/2019
- prospects for interest rates
- the borrowing strategy
- the borrowing requirement 2016/2017
- 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 2016/2017 to 2018/2019

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 2015/2016

The Bank of England Base Rate has remained at 0.50% since 5th March 2009 and is predicted by Capita Asset Services (the Council's treasury advisors) to remain at that level until the fourth quarter in 2016 when it will begin to gradually rise until reaching 1.75% in December 2018. A number of analysts do not expect rates to begin to rise until 2017. The level of Consumer Price Inflation fell to -0.1% in April 2015. This was the lowest rate since estimates of this measure began in 1988. The CPI rate had increased to 0.2% by December 2015 but it is unlikely to reach 1% until the second half of 2016 and could remain below the Bank of England target of 2.0% until 2018. There is considerably uncertainty, but forecasts of low levels of inflation, weak growth in China and the Eurozone, and the continuing need to stimulate growth in the UK means that pressure to increase the Base Rate is low. The actual path for monetary policy will be dependent on prevailing economic conditions and 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 2016/2017 and beyond.

PWLB rates have continued to be very volatile during 2015/2016 so far in response to economic news and world events. The 2015 Spending Review and Autumn Statement published in November increased the UK growth forecast for 2016 from 2.3% to 2.4% and for 2017 from 2.4% to 2.5% however there are worries over growth prospects and particular concerns that growth in China is losing momentum and there are also geopolitical concerns particularly over Ukraine and the Middle East. Uncertainty is expected to continue into the medium term but the overall expectation is for PWLB rates to rise over time as world growth recovers and investors switch from bonds to equities.

The government introduced a 0.20% discount on PWLB loans under the prudential borrowing regime in March 2012 for those authorities that provided 'improved information and transparency on their locally determined long-term borrowing and associated capital spending plans'. 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 2016.

The following table shows the average PWLB rates for Quarters 1, 2 and 3 and Quarter 4 to 19th January 2016.

2015/2016	Qtr 1* (Apr - June) %	Qtr 2* (July - Sep) %	Qtr 3* (Oct – Dec) %	Qtr 4* (rates at 19th Jan 2016)
7 days notice	**0.36**	**0.36**	**0.36**	**0.36**
1 year	**1.23***	**1.29***	**1.23***	**1.13***
5 year	**2.09***	**2.15***	**2.05***	**1.97***
10 year	**2.75***	**2.78***	**2.69***	**2.61***
25 year	**3.37***	**3.40***	**3.41***	**3.37***
50 year	**3.29***	**3.28***	**3.27***	**3.19***

*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 2015/2016**

The Council's strategy for 2015/2016 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 4.25% for long-term borrowing was set in the Treasury Management Policy and Strategy Statement for 2015/2016.

There have continued to be high levels of volatility in the financial markets and with borrowing rates still forecast to remain relatively low over the short term no new borrowing has been undertaken in the current financial year up to 19th January 2016.

The Treasury Management team continues to monitor PWLB rates closely to assess the value of possible further new borrowing at the bottom of the rate curve in line with the Authority's future Capital Programme requirements.

The Borrowing Strategy for 2015/2016 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 2015/2016 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 have been received and none are expected for the outstanding rollover period LOBO's with Dexia Credit Local and so these arrangements will continue.

Roll Over Dates	Lender	Amount £m	Rate %	Roll Over Periods
21/04/2015 and 21/10/2015	Barclays	5.0	4.50	every 6 months
29/09/2015	Dexia Credit Local	5.0	4.45	every 3 years
03/02/2016	Dexia Credit Local	5.0	4.37	every 3 years
22/02/2016	Dexia Credit Local	5.0	4.38	every 3 years
Total		**20.0**		

2.2.3 **Current Portfolio Position**

The Council's treasury portfolio position at 31st December 2015 comprised:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	177.8		
	Market (LOBO's)	39.5		
	Other	0.6	217.9	3.91
Variable Rate Funding	Temporary / Other		27.6	0.41
Total Borrowing			**245.5**	**3.51**
Total Investments	In House–short term*		**265.4**	**0.91**
Net Surplus			**19.9**	

* The total investments figure includes monies invested on behalf of ANEC which agreed with its member authorities that the council would invest its surplus funds

The Council currently has a net surplus of £19.9m which represents the difference between gross debt and total investments and is significantly lower than 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 more importance, 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 2016/2017 – 2018/2019**

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.

- 2015/2016 0.50%
- 2016/2017 0.50% - 0.75%
- 2017/2018 0.75% - 1.25%
- 2018/2019 1.25% - 1.75%

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 and there will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns. 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 2016/2017**

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

		2016/17 £m	**2017/18 £m**	**2018/19 £m**
1.	Capital Programme Borrowing	70.0	61.0	3.8
2.	Replacement borrowing (PWLB)	0.0	4.0	5.0
3.	Replacement LOBO)	10.0	19.5	20.0
TOTAL		**80.0**	**84.5**	**28.8**

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 2016	0.50	2.00	3.40	3.20
June 2016	0.50	2.10	3.40	3.20
Sept 2016	0.50	2.20	3.50	3.30
Dec 2016	0.75	2.30	3.60	3.40
March 2017	0.75	2.40	3.70	3.50
June 2017	1.00	2.50	3.70	3.60
Sept 2017	1.00	2.60	3.80	3.70
Dec 2017	1.25	2.70	3.90	3.80
March 2018	1.25	2.80	4.00	3.90
June 2018	1.50	2.90	4.00	3.90
Sept 2018	1.50	3.00	4.10	4.00
Dec 2018	1.75	3.10	4.10	4.00
March 2019	1.75	3.20	4.10	4.00

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 US Federal Funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, 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, an increase in geopolitical risks abroad 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 4.00% for any further long-term borrowing for 2016/2017 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 2016/2017. 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 2016/2017. 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 2016/2017 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 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 capital 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, bond funds, gilt funds, property funds 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. Regulatory changes that have been made 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.

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. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these “uplifts” with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases these factors have “netted” each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody’s) Financial Strength rating withdrawn by the agency.

In keeping with the agencies’ new methodologies, the rating element of our credit assessment process now focuses solely on the Short and Long Term ratings of an institution. The evolving regulatory environment, in tandem with the rating agencies’ new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. While this Council understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA+. This is due to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

It is important to stress the regulatory changes that are being made in the UK and the rest of Europe are designed to make the financial system sounder, their implementation will not suddenly weaken institutions and that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now.

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 2015/2016 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 compared to the relevant benchmarks and performance from the previous year:

Return	2014/15 Benchmark %	2014/15 Return %	To date 2015/16 Benchmark %	To date 2015/16 %
Council	0.35	0.76	0.36	0.91

During 2016/2017 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 compares 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 2016/2017 are likely to range between £60 million and £220 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 2016/2017, with short-term interest rates forecast to be materially below long-term rates, it is likely 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 2016/2017 (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 no undue reliance is 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	Full Council	Reaffirmed annually and updated as appropriate

Area of Responsibility	Council/ Committee/ Officer	Frequency
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
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 to manage 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 and Capital Economics (an independent forecasting consultancy).

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

1. Interest Rate Forecasts

PWLB rates and forecasts shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

Capita Asset Services Interest Rate View													
	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%
6 Month LIBID	0.70%	0.70%	0.80%	0.90%	1.00%	1.20%	1.30%	1.50%	1.60%	1.70%	1.80%	2.00%	2.20%
12 Month LIBID	1.00%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.80%	1.90%	2.00%	2.10%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB Rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB Rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
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%	1.50%	1.75%	1.75%
Capital Economics	0.50%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
Capital Economics	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
Capital Economics	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

2. Survey of Economic Forecasts

HM Treasury December 2015

The current Q4 2015 and 2016 base rate forecasts are based from samples of both City and non-City forecasters included in the HM Treasury December 2015 report.

BANK RATE FORECASTS	Quarter ended Q4 2015	Q4 2016	annual average Bank Rate ave. 2017	ave. 2018	ave. 2019
Average	0.50%	0.90%	1.40%	2.10%	2.60%
Highest	0.50%	1.30%	1.80%	2.50%	3.10%
Lowest	0.50%	0.70%	1.20%	1.40%	1.60%

Economic Background **Appendix 5**

1.1 Global Economy Update

The Eurozone

In the Eurozone, the ECB announced a €1.1 trillion programme of quantitative easing in January 2015 to buy up high quality government and other debt of selected EZ countries. This programme of €60bn monthly purchases started in March 2015 and is intended to run initially to September 2016. The policy appears to have had a positive effect in helping a recovery in consumer and business confidence and to start an improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.2% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% (1.6% y/y) in quarter 3. Lower than anticipated growth, combined with recent downbeat Chinese and emerging markets news, has prompted comments by the ECB that it stands ready to strengthen this programme of QE by extending its time frame and/or increasing its size in order to increase inflation from the current level of around zero towards its target of 2%. The ECB will also aim to help boost the rate of growth in the EZ.

In July 2015, Greece agreed to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it has not addressed the unsupportable size of total Greek debt compared to GDP. Damage has also been done to the Greek banking system and economy by initial resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

The general elections in Portugal and Spain, during September 2015 and December 2015 respectively, have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost power. A left wing/communist coalition has taken power in Portugal which is heading towards unravelling previous pro-austerity reforms. This outcome could be replicated in Spain and has created nervousness in bond and equity markets for these countries with the potential to impact on the whole Eurozone.

USA

GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, there was strong growth in Q2 to 3.9% before falling back to +2.1% in Q3.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Federal Reserve would start to increase rates in September. They delayed the first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as due to a 20% rise in the value of the dollar which has caused the Federal Reserve to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was strong while

November was also reasonably strong and December was very strong. This paved the way for the Federal Reserve to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by the UK Monetary Policy Committee.

China

The Chinese Government has been active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market during the summer. Many commentators are concerned that recent growth figures could have been massaged to hide a move to a lower growth figure. There are also major concerns as to the creditworthiness of much of the bank lending to corporations and local government during the post-2008 credit expansion period. Overall, China is still expected to achieve a high growth figure but nevertheless, there are concerns about whether the Chinese economy can continue to grow at such a fast rate, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, also remains a concern.

Japan

Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of +1.1% during Q1. Growth then increased by +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession. This would have been the fourth recession in five years as Japan has been hit hard by the downturn in China during 2015. There are continuing concerns as to how effective government efforts to stimulate growth, and increase the rate of inflation from near zero, are likely to prove as initial attempts at reform have failed to achieve the desired outcomes and apparent government reluctance to address deregulation of protected and inefficient areas of the economy.

1.2 UK economy

Economic growth

UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest of any G7 country and the 2014 growth rate was the strongest UK rate since 2006. Growth figures for 2015 are also amongst the strongest in the G7 again, although they may end up lower than expected. Growth forecasts in the range 2.5% - 2.7% are expected over the next three years but for this recovery to be more balanced and sustainable in the longer term further movement away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure is needed. Sustained growth since 2012 has resulted in unemployment falling quickly to its current level of 5.2%.

There are concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. This has led to differing views on the timing of rate rises and what options would be available in the event of another financial crisis in the near future. But it is unlikely that either the UK or US would raise rates until they are sufficiently confident that growth was securely embedded and inflation was on course towards the 2% target.

Whilst the timing of any rise in the Bank Rate has slipped further and further analysts are in general agreement that, when they do begin, the scale and pace of these increases will be much lower than prevailed before 2008 reflecting the much bigger effect on heavily indebted consumers and householders than they did before 2008.

Forward guidance

Since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK. Bank of England Governor Mark Carney has set three criteria that need to be met before he would consider making a start on increasing Bank Rate. These criteria are patently not being met at the current time (as he confirmed in a speech on 19 January):

- Quarter-on-quarter GDP growth is above 0.6% i.e. using up spare capacity. This condition was met in Q2 2015, but Q3 came up short and Q4 looks likely to also fall short.
- Core inflation (stripping out most of the effect of decreases in oil prices), registers a concerted increase towards the MPC's 2% target. This measure was on a steadily decreasing trend since mid-2014 until November 2015 at 1.2%. December 2015 saw a slight increase to 1.4%.
- Unit wage costs are on a significant increasing trend. This would imply that spare capacity for increases in employment and productivity gains are being exhausted, and that further economic growth will fuel inflationary pressures.

Inflation

Bank of England Inflation Report forecast is for CPI inflation to be subdued and barely getting back to the 2% target within the 2-3 year time horizon. The December 2015 Report shows CPI inflation rising to 0.2% from 0.1% in November with analysts forecasting CPI inflation rising to around 1% in the second half of 2016 and not getting near to 2% until 2017. The official MPC report itself identifies an even slower rate of increase. Considerable uncertainty over the scale and pace of pay and CPI inflation makes predications on when the BoE MPC will decide to start increasing the Bank Rate difficult.

However, with the price of oil having fallen further in January 2016, and with sanctions having been lifted on Iran, enabling it to sell oil freely into international markets, there could well be some further falls still to come in 2016. The price of other commodities exported by emerging countries could also have downside risk and several have seen their currencies already fall by 20-30% (or more), over the last year. These developments could well lead the Bank of England to lower the pace of increases in inflation in its February 2016 Inflation Report. On the other hand, the start of the national living wage in April 2016 (and further staged increases until 2020), will raise wage inflation; however, it could also result in a decrease in employment so the overall inflationary impact may be muted.

Government Debt

Whilst still continuing with austerity measures, the Government's revised Budget in July 2015 eased the pace of cuts from achieving a budget surplus in 2018/2019 to achieving one in 2019/2020 and this timetable was maintained in the Autumn Statement with a forecast surplus of £10.1bn. Ahead of this timeframe, the forecast deficit in 2015/2016 has reduced from £74.1bn to £73.5bn but the 2016/2017 target has increased from £46.7bn to £49.9bn.

1.3 Economic Forecast

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in rates and bond yields is likely to continue as investors move funds between more risky assets i.e. equities with the potential for higher returns or the safe haven of bonds.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established. This will be accompanied by rising inflation and consequent increases in Bank Rate and the eventual unwinding of Quantitative Easing. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. The UK remains exposed to vulnerabilities in a number of key areas. And the balance of risk linked to Bank Rate forecasts is probably to the downside i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth and forecasts for inflation increases are lower than currently expected The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively over the last year from Q4 2015 to Q4 2016. Increases after that are also likely to be at a much slower pace and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008. There has also been an increase in momentum towards holding a referendum on membership of the EU in 2016, rather than in 2017, with Q3 2016 being the current front runner in terms of timing; this could impact on MPC considerations to hold off from a first increase until the uncertainty caused by it has passed.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and also in China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, particularly in the Eurozone and Japan

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

- Uncertainty around the risk of a UK exit from the EU, with a referendum due to be held by the end of 2017.
- The commencement by the US Federal Reserve of increases in the central rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to 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.

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.

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 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.

** 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.