REPORT FOR:	GOVERNANCE, AUDIT, RISK MANAGEMENT AND STANDARDS COMMITTEE
Date of Meeting:	28 January 2016
Subject:	Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy for 2016/17
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards affected:	All
Enclosures:	Appendix 1 – Legislation and Regulations Impacting on Treasury Management Appendix 2 – Treasury Management Delegations and Responsibilities Appendix 3 – Economic Background

Section 1 – Summary and Recommendation

Summary:

This report sets out the Council's Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy for 2016/17.

Recommendation:

The Committee is requested to review and comment on:

- Treasury Management Strategy Statement and Prudential Indicators for 2016/17;
- Minimum Revenue Provision Policy Statement for 2016/17;
- Annual Investment Strategy for 2016/17.
- That the maximum total investment in the Investment Property Strategy be set at £20m
- That the limit of investments for over 364 days be increased to £60m.

Reason

To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

The Committee is responsible for ensuring effective scrutiny of the Treasury Management Strategy and associated strategies and policies.

Section 2 – Report

1. INTRODUCTION

1.1 Background

1. The Chartered Institute of Public Finance and Accountancy (CIPFA) defines Treasury Management 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."

   The Council has adopted this definition.

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

3. The second main function of the Treasury Management service is the funding of the Council's capital programme. This programme provides a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, any debt previously drawn may be restructured to meet Council risk or cost objectives.

4. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code (The Prudential Code for Capital Finance in Local Authorities [CIPFA 2011 Edition]) and Treasury Management Code (Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes [CIPFA 2011 Edition]), in setting Treasury and Prudential Indicators for the next three years and in ensuring that the Council's capital investment programme is affordable, prudent and sustainable.

5. The Act, the Codes and Department for Communities and Local Government Investment Guidance (2010) require the Council to set out its Treasury Strategy for Borrowing and to prepare an Annual Investment Strategy that establishes the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. A summary of the relevant legislation, regulations and guidance is included as Appendix 1.

6. The budget for each financial year includes the revenue costs that flow from capital financing decisions. Under the Treasury Management Code, increases in capital expenditure should be limited to levels whereby increases in interest charges and running costs are affordable within the projected income of the Council for the foreseeable future.

7. 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.

8. The Council recognises that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

1.2 CIPFA Requirements

9. The Council has formally adopted the Treasury Management Code, the primary requirements of which are as follows:

   - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

   - Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.

   - Receipt by the full Council and/or Cabinet of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

   - Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

   - Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

1.3 Reporting Requirements

10. As introduced above, the Council and/or Cabinet are required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

    Treasury Management Strategy Statement report (this report) - The first, and most important report is presented to the Council in February and covers:
    - the capital programme (including Prudential Indicators);
    - a Minimum Revenue Provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
    - the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
    - an investment strategy (the parameters on how investments are to be managed).

    Mid-year Review report – This is presented to Cabinet in the autumn and updates Members on the progress of the capital position, reporting on Prudential Indicators and identifying whether the treasury strategy is meeting the objectives or whether any policies require revision.

Treasury Management Outturn report – This is presented to Cabinet in June/July and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the Strategy.

Scrutiny - The above reports are required to be adequately scrutinised with the role being undertaken by the the Governance, Audit, Risk Management and Standards Committee (GARMSC).

11. The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and treasury management practices to the Section 151 officer. The Section 151 Officer chairs the Treasury Management Group (TMG), which monitors the treasury management activity and market conditions.

12. Further details of responsibilities are given in Appendix 2.

1.4 Training

13. The Treasury Management Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in this area. This especially applies to Members responsible for scrutiny.

14. The Council's Treasury Management Advisers will provide an updated training session for all Members of GARMSC and other interested Members and other training opportunities will be offered as appropriate.

15. The training needs of Treasury Management officers are periodically reviewed as part of the Learning and Development programme with appropriate training and support provided.

1.5 Treasury Management Advisers

16. The Council has engaged Capita Asset Services, Treasury Solutions as its external Treasury Management Advisers.

17. However, the Council recognises that responsibility for treasury management decisions remains with itself at all times and will ensure that undue reliance is not placed upon external service providers.

18. 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 is assessed are properly agreed and documented, and subjected to regular review.

1.6 Treasury Management Strategy for 2016/17

19. The Strategy covers:-

Capital Issues (Paragraph 2)

- Capital programme and Prudential Indicators (Paragraph 2.1);
- Capital Financing Requirement (Paragraph 2.2);
- Minimum Revenue Provision Policy (Paragraph 2.3).

Treasury Management Issues (Paragraph 3)

- Affordability Prudential Indicators (Paragraph 3.1);
- Borrowing and Investments (Paragraph 3.2);
- Prospects for Interest Rates and Economic Commentary (Paragraph 3.3);
- Borrowing Strategy (Paragraph 3.4);
- Treasury Management Limits on Activity (Paragraph 3.5);
- Policy on borrowing in advance of need (Paragraph 3.6);
- Debt rescheduling (Paragraph 3.7);
- Annual Investment Strategy (Paragraph 3.8).

20. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Department for Communities and Local Government (DCLG) Minimum Revenue Provision Guidance, the CIPFA Treasury Management Code and DCLG Investment Guidance.

21. It is not considered necessary to produce a separate treasury strategy for the Housing Revenue Account (HRA) in light of the co-mingling of debt and investments between HRA and the General Fund. Where appropriate, details of allocations of balances and interest to HRA are contained in this report.

2. CAPITAL ISSUES

22. The Council's capital expenditure programme is the key driver of treasury management activity. The output of the programme is reflected in the Prudential Indicators, which are designed to assist Members' overview and confirm the capital expenditure programme. The values shown in the tables for 2014-15 and 2015-16 are actual and estimated outturn respectively and not the strategy for those years.

2.1 Capital Programme and Prudential Indicators

23. The first prudential indicator is a summary of the Council's capital expenditure based on the approved capital programme. Amendments may be necessary in the light of decisions taken during the budget cycle. The table below summarises the capital expenditure programme and the ways in which it will be financed. Any shortfall of resources results in a financing need.

Table 1 Capital Expenditure and Funding

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Expenditure					
Community Health & Wellbeing	3,443				
Children & Families	23,057				
Environmen & Enterprise	21,915				
Resources	9,512	16,917	20,525	8,249	3,193
Adults		721	1,750	2,640	1,540
Schools		52,134	16,170	15,465	10,110
Environmental Services		18,867	15,520	23,508	22,408
Community and Culture		1,449	6,490	1,650	460
Housing General Fund		5,199	16,970	9,470	1,970
Regeneration		3,416	25,480	14,250	250
Infrastructure			5,000		
HRA	4,443	18,264	25,550	17,038	9,139
TOTAL	**62,370**	**116,967**	**133,455**	**92,270**	**49,070**
Funding:-					
Grants	27,779	56,060	25,759	20,115	19,553
Capital receipts	179	3,312	10,398	4,935	1,045
Revenue financing	5,534	11,853	9,987	11,103	8,024
Section 106 / Section 20	553	1,606	1,565	1,000	0
TOTAL	**34,045**	**72,831**	**47,709**	**37,153**	**28,622**
Net financing need for the year	**28,325**	**44,136**	**85,746**	**55,117**	**20,448**

2.2 Capital Financing Requirement

24. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any new capital expenditure, which has not immediately been paid for, will increase the CFR.

25. The CFR does not increase indefinitely, as the MRP is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

26. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a funding facility and so the Council is not required to borrow separately for them. The Council currently has £17m of such schemes within the CFR.

27. CFR projections are included in the table below.

Table 2 Capital Financing Requirement

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
CFR as at 31 March					
Non – HRA	256,390	286,943	356,142	396,779	401,829
HRA	149,507	151,213	154,783	154,753	154,723
TOTAL	**405,897**	**438,156**	**510,925**	**551,532**	**556,552**
Annual change in CFR					
Capital expenditure	62,370	116,967	133,455	92,270	49,070
Non-borrowing sources of funding	- 34,045	- 72,831	- 47,709	- 37,153	- 28,622
Lease liability	500	500	389	410	456
Less MRP	- 16,681	- 12,377	- 13,365	- 14,920	- 15,884
TOTAL	**12,144**	**32,259**	**72,769**	**40,607**	**5,020**

The Non-HRA CFR increases over the five years from £256m to £402m reflecting the existing regeneration programme, the property investment portfolio, the schools expansion, re-building and improvements programme, the renewal and replacement of highways, footways and streetlighting, the purchase of properties for temporary accommodation and upgrades and enhancements to ICT systems. Through a special determination the debt limit for the HRA has been increased to £154.8m and work will be carried out in line with this increase.

2.3. Minimum Revenue Provision Policy

28. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. The accounting approach is to spread the cost over the the estimated useful life of the asset. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by which capital expenditure, which is financed by borrowing or credit arrangements, is funded by Council Tax and housing rents.

29. The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (the Regulations) require the Council to approve a Minimum Revenue Provision (MRP) Statement setting out what provision is to be made in the General Fund for the repayment of debt, and how the provision is to be calculated. The purpose of the Statement is to ensure the provision is prudent, allowing the debt to be repaid over a period reasonably commensurate with that over which the capital expenditure benefits. The first point in the Statement is the subject of a separate report to Council and, subject to their agreement, the Council is recommended to approve the following MRP Statement:

- For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be the equal annual reduction of 2% of the outstanding debt at 1 April 2015 for the subsequent 50 years.

- For all capital expenditure financed from unsupported (prudential) borrowing (including PFI and finance leases), MRP will be based upon an asset life method in accordance with Option 3 of the guidance.

- In some cases where a scheme is financed by prudential borrowing it may be appropriate to vary the profile of the MRP charge to reflect the future income streams associated with the asset, whilst retaining the principle that the full amount of borrowing will be charged as MRP over the asset's estimated useful life.

- A voluntary MRP may be made from either revenue or voluntarily set aside capital receipts.

- Estimated life periods and amortisation methodologies will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

- Freehold land cannot properly have a life attributed to it, so for the purposes of Asset Life method it will be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate will be used for the land.

- As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

- Repayments included in annual PFI or finance leases are applied as MRP.

- Where borrowing is undertaken for the construction of new assets, MRP will only become chargeable once such assets are completed and operational.

- Under Treasury Management best practice the Council may decide to defer borrowing up to the capital financing requirement (CFR) and use internal resources instead. Where internal borrowing has been used, the amount chargeable as MRP may be adjusted to reflect the deferral of actual borrowing.

3. TREASURY MANAGEMENT ISSUES

3.1 Affordability Prudential Indicators

30. The previous sections cover the overall capital and control of borrowing Prudential Indicators but within this framework Prudential Indicators are also required to assess the affordability of the capital investment programme. These provide an indication of the impact of the programme on the Council's overall finances.

3.1.1 Ratio of Financing Costs to Revenue Stream

31. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in the budget report.

Table 3 Ratio of Financing Costs to Revenue Stream

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	%	%	%	%	%
Non - HRA	14	13	13	15	17
HRA	48	41	40	45	45

3.1.2 Incremental Impact of Capital Investment Decisions on Council Tax and Housing Rents

32. This indicator identifies the revenue costs associated with proposed capital programme and the impact on Council Tax and Housing Rents.

Table 4 Incremental Impact of Capital Investment Decisions

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£	£	£	£	£
Increase in Council Tax (band D) per annum	33.32	36.62	62.02	58.03	30.66
Increase in average housing rent per week	0.11	- 1.71	- 1.33	4.14	- 0.01

3.1.3 Local HRA indicators

33. The Council should also be aware of the following ratios when making its treasury management decisions.

Table 5 HRA Ratios

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
Debt (CFR) (£m)	149.5	151.2	154.8	154.8	154.7
Gross Revenue Stream (£m)	31.8	32.2	32.2	32.3	32.0
Ratio of Gross Revenue Stream to Debt (%)	**21**	**21**	**21**	**21**	**21**
Average Number of Dwellings	4,892	4,867	4,816	4,860	4,845
Debt outstanding per dwelling (£)	**30,565**	**31,069**	**32,143**	**31,846**	**31,935**

Rents in the Housing Revenue Account are projected to reduce by 1% each year for four years commencing in 2016/17, in line with the provisions of the Welfare reform and Work Bill, which is anticipated to have been enacted before the start of the new financial year. The reduction in income is expected to be mitigated over the next two years by additional rent income generated as a result of an increase in HRA property numbers from the Council's HRA new build and purchase and repair programmes.

3.2 Borrowing and Investments

34. The capital expenditure programme set out in Paragraph 23 provides details of the service activity of the Council. 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 the activities of the Council. This involves both the organisation of the cash flow and, where the capital programme requires it, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury indicators, the current and projected debt positions and the annual investment strategy.

3.2.1 Current portfolio position

35. The Council's borrowing position at 31 December 2015 is summarised below.

Table 6 Summary Borrowing & Investment Position at 31 December 2015

		Principal		Ave. rate
		£m	£m	%
Fixed rate funding	PWLB	218.5		
	Market	116.0	334.5	4.25
Variable rate funding			0	
Other long term liabilities (PFI & leases)			18.0	
Total Debt			352.5	
Total Investments at 31.12.2015			109.2	0.8

36. The Council has borrowed £83.8 million under Lender Option, Borrower Option (LOBO) structures with maturities between 2050 and 2078. In exchange for an interest rate that was below that offered on long term debt by the PWLB, the lender has the option at the end of five years (and half yearly thereafter) to reset the interest rate. If the rate of interest changes, the Council is permitted to repay the loan at no additional cost.

37. The Council's borrowing position with forward projections is summarised below. The table shows the actual external debt, against the underlying capital borrowing need, highlighting any under or over borrowing.

Table 7 Changes to Gross Debt

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
External Debt					
Debt at 1 April	340,293	334,460	359,466	445,181	500,267
Expected change in Debt	- 5,833	25,007	85,715	55,086	20,417
Other long-term liabilities (OLTL) 1st April	21,841	18,534	17,733	16,907	16,161
Expected change in OLTL	- 3,307	- 801	- 826	- 746	- 593
Actual gross debt at 31 march	352,994	377,199	462,088	516,428	536,252
Capital financing requirement	405,897	438,156	510,925	551,532	556,552
Under / (Over) borrowing	**52,903**	**60,957**	**48,837**	**35,104**	**20,300**

38. The expected change in debt in 2015/16, 2016/17, 2017/18 and 2018/19 reflects the anticipated borrowing necessary to meet the capital programme described in Table 1.

39. Debt outstanding should not normally exceed CFR.

40. Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

41. The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing programmes and the proposals in the budget report.

42. The table below shows the net borrowing after investment balances are taken into account.

Table 8 Net Borrowing

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Gross Borrowing brought forward 1 April	362,134	352,994	377,199	462,088	516,428
Changes to Gross Borrowing	-9,140	24,206	84,889	54,340	19,824
Carry Forward 31st March	352,994	377,199	462,088	516,428	536,252
Investment brought forward 1 April	-130,833	-119,078	-60,000	-60,000	-60,000
Changes to Gross Borrowing	-11,755	-59,078	0	0	0
Carry Forward 31st March	-119,078	-60,000	-60,000	-60,000	-60,000
Total Net Borrowing	233,916	317,199	402,088	456,428	476,252
Change in net borrowing	**2,615**	**83,284**	**84,889**	**54,340**	**19,824**

The change in net borrowing in 2015/16 arises mainly from the reduction in cash balances of £59m and in subsequent years from additional borrowing.

3.2.2 Treasury Indicators: limits to borrowing activity

The Operational Boundary

43. This is the limit which external debt is not normally expected to exceed.

44. The boundary is based on current debt plus anticipated net financing need for future years.

The Authorised Limit for External Debt.

45. This is a further key prudential indicator which represents a control on the maximum level of borrowing. It represents a limit beyond which external debt is prohibited. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term. It relates to the financing of the capital programme by both external borrowing and other forms of liability, such as credit arrangements.

46. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' programmes, or those of a specific council, although this power has not yet been exercised.

Table 9 Operational boundary and authorised limit

	2014/15	2015/16	2016/17	2017/18	2018/19
	£m	£m	£m	£m	£m
Authorised Limit for external debt					
Borrowing and finance leases	406	438	511	552	557
Operational Boundary for external debt					
Borrowing	334	359	445	500	521
Other long term liabilities	19	18	17	16	16
Total	353	377	462	516	536
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing	334	359	445	500	521
Upper limit for variable rate exposure					
Net principal re variable rate borrowing	-	-	-	-	-
Upper limit for principal sums invested over 364 days*	28	41	60	60	60

As shown in table 13 below, the Council may wish to make additional investments of over 364 days. The current limit for such investments is £40m. To respond to potential new initiatives it is recommended that at this stage the limit for investments over 364 days be set at £60m.

HRA Debt Limit

47. Separately, the Council is also limited to a maximum HRA debt limit through the HRA self-financing regime. This limit and the HRA CFR are shown in the table below.

Table 10 HRA Debt Limit and CFR

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'001	£'002
HRA Debt Limit	149,648	151,337	154,937	154,937	154,937
HRA CFR	149,526	151,213	154,783	154,753	154,723
Headroom	122	124	154	184	214

3.3 Prospects for Interest Rates and Economic Commentary

48. The Treasury Management Adviser has provided the commentary in the remainder of this section 3.3 and a more detailed economic commentary is included as Appendix 3.

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

Capita Asset Services Interest Rate View														
	Dec-15	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
Capita Asset Services View	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
5yr PWLB Rate	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
10yr PWLB View	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
25yr PWLB View	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
50yr PWLB Rate	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%

United Kingdom

UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, probably being second to the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y) before weakening again to +0.5% (2.3% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015 this year. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have distinctly weakened and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

The Inflation Report was notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1 percent in the second half of 2016. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. There is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate.

USA

The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then weakened again to 2.1% in quarter 3. The downbeat news in late August and in September about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision at its September meeting to pull back from a first rate increase. However, the nonfarm payrolls figure for growth in employment in October was very strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided, has now firmly opened up the possibility of a first rate rise in December.

Eurozone

In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece

During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the 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 Greek exit from the euro may only have been delayed by this latest bailout.

Overview

- *Investment returns are likely to remain relatively low during 2016/17 and beyond;*

- *Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenominally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;*

- *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.*

3.4 Borrowing Strategy

49. As shown in the tables above, currently the Council has a debt portfolio of £353m, mainly long term, with an average maturity of 36 years assuming no early repayment of the LOBO loans. Cash balances have remained high and at 31 December 2015 were £109m. With the investment portfolio yielding around 1% and the likely average cost of new debt 3.5%, there is a substantial short term cost to carrying excessive debt.

50. As shown in Table 7 above the Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (CFR), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary source of funding. This strategy is prudent with investment returns low and counterparty risk relatively high.

51. For the last few years the capital programme has been funded from grants and revenue resources and there has not been a need for further borrowing. However, with the reduction in cash balances and the likelihood that they will be further reduced by the end of 2015/16 much of the increased capital programme in the next few years will need to be funded from borrowing. As shown in Table 7 above, it is currently estimated that sums of £25m, £86m, £55m and £20m will need to be borrowed in the current year next three years respectively. The Council will have a range of funding sources available and will need to base its decisions on optimum borrowing times and periods taking into account current interest rates and likely future movements and the "cost of carry" (difference between rates for borrowing and rates for investments) which currently remain high. A strategy is being devised in consultation with the Treasury Management Adviser. It is also possible that new long term borrowing in the next three years might be required either if part of the LOBO portfolio had to be refinanced early.

52. It may be necessary to resort to temporary borrowing from the money markets or other local authorities to cover mismatches in timing between capital grants and payments. However with several Government grants now paid early in the financial year this is not very likely.

53. Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury management operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

54. The Council has adopted a single pooled approach for debt. Allocations to HRA are based on its CFR, with interest charged to HRA at the average rate on all external borrowing. Longer term, the HRA's ability to repay borrowing will depend on future revenues and the capital expenditure programme.

3.5 Treasury Management Limits on Activity

55. There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs and improve performance.

Upper limit on variable interest rate exposure

56. This identifies a maximum limit for variable interest rates based upon the debt position net of investments. As shown in Table 9 above the Council does not expect to undertake any borrowing on this basis.

Upper limit on fixed interest rate exposure

57. This identifies a maximum limit for fixed interest rates based upon the debt position net of investments. The Council's proposed limits are shown in Table 9 above

Maturity Structure of Borrowing

58. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

59. The Council has no variable rate borrowing and the comments below relate only to its fixed rate portfolio.

60. In the table below, the maturity structure for the LOBO debt, in accordance with CIPFA Guidance, is shown as the first date that the interest rate can be increased.

<u>Table 11 Maturity Structure of Fixed Rate Borrowing</u>

	As at 31.12.2015 %	Upper limit %	Lower limit %
Under 12 months	25	30	0
12 months to 23 months	3	20	0
24 months to under 5 years	7	30	0
5 years to under 10 years	1	40	0
10 years and over	64	90	30

3.6 Policy on Borrowing in Advance of Need

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

62. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.7 Debt Rescheduling

63. Capita currently advise that:

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these 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).

The reasons for any rescheduling to take place will include:

- *the generation of cash savings and / or discounted cash flow savings;*
- *helping to fulfil the treasury strategy;*
- *enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).*

64. Opportunities to reduce the cost of debt by premature repayment or to improve the maturity profile are kept under review in discussion with the Council's Treasury Management Adviser. Early repayment of market loans is by negotiation. For PWLB loans, there are daily published prices for early repayment that allows analysis of the opportunities for restructuring. There is currently a spread which has generally made restructuring uneconomic.

65. Should any of the LOBO loans with interest rate reset dates in 2016-17 (£83.8m) require refinancing, the most likely source will be external borrowing.

66. All rescheduling will be reported to Cabinet at the earliest meeting following the exercise.

3.8 Annual Investment Strategy

3.8.1 Changes to credit rating methodology

67. During the last year there have been significant changes in the methodologies adopted by the the three main credit rating agencies and the Council's Treasury Management Adviser comments as follows:

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 own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

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. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority (Harrow) understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AAA. This is in relation 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 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 suddenly 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 fact, 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. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

68. These changes are reflected in the Council's counterparty lists described in Tables 12 and 13 below.

3.8.2 Investment policy

69. The Council's investment policy has regard to the Department for Communities and Local Government Investment Guidance and the CIPFA Treasury Management Code. The Council's investment priorities will be security first, liquidity second, then return.

70. In accordance with the above guidance and in order to minimise the risk to investments, the Council below clearly stipulates the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies. The Treasury Management Adviser monitors counterparty ratings on a real time basis with knowledge of any changes advised electronically as the agencies notify modifications.

71. Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to assess continually 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 adviser to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

72. The aim of the strategy is to generate a list of highly creditworthy counterparties which will provide security of investments, enable divesification and minimise risk.

73. Investment instruments identified for current use are listed in Tables 12 and 13 below under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices.

3.8.3 Creditworthiness policy

74. The primary principle governing the Council's investment criteria is the security of its investments, although the return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

75. The Director of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

76. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria.

77. Credit rating information is supplied by the Treasury Management Adviser on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

78. The Council's criteria for an institution to become a counterparty are:

Specified Investments

These are sterling investments of a maturity period of not more than 364 days, or those which could be for a longer period but where the lender has the right to be repaid within 364 days if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. The instruments and credit criteria to be used are set out in the table below.

Table 12: Specified Investments

Instrument	Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility	Government backed	In-house
Term deposits – other LAs	Local Authority issue	In-house
Term deposits – banks and building societies	AA- Long Term F1+Short-term 2 Support UK or AAA Sovereign	In-house
Money Market Funds	AAA	In-house

Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as Specified above). They normally offer the prospect of higher returns but carry a higher risk. The identification and rationale supporting the selection of these other investments are set out in the table below.

Table 13: Non - Specified Investments

	Minimum Credit Criteria	Use	Max total investment	Max. maturity period
Term deposits – banks and building societies (excluding Lloyds / HBOS)	A Long Term F1 Short-term UK or AAA Sovereign	In-house	50%	3 months
Lloyds / HBOS	A Long Term F1 Short-term	In-house	50%	6 months
Callable Deposits	A Long Term F1 Short term	In-house	20%	3 months
UK nationalised Banks [RBS]	F2 Short-term	In-house	60%	36 months
Enhanced Cash Funds	AAA	In-house	25% (maximum £10 million per fund)	Minimum monthly redemption
Corporate bonds pooled funds, other non-standard investments and gilts		In house	£10m in total	Dependent on specific agreement
HB Public Law Ltd		In house	£0.1m	36 months
Investment Property Strategy		In house	£20.0m	Dependent on specific agreement
Concilium Business Services Ltd t/a Smart Lettings Ltd		In house	£0.274m	36 months
Concilium Group Startup capital		In house	£0.702m	60 months
Concilium Group 5% Long Term Investment		In house	£1.5m	Dependent on specific agreement
Cultura London re Harrow Arts Centre		In house	£1m	25 years
Housing Development Vehicle (LLP) – Initially on acquisition of 100 homes		In house	£30m	Dependent on specific agreement

Unless specified above, individual bank & building society counterparty limits that are consistent with the above limits are approved by the Section 151 Officer in accordance with the Council's Treasury Management Practices.

3.8.4 Country Limits

79. The Council has determined that it will only use approved counterparties from the UK or from countries with a minimum sovereign credit rating of AAA. Currently the only countries meeting this criterion are Australia, Canada, Denmark, Germany, Singapore, Sweden and Switzerland. The current UK rating is the second level of AA+. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

3.8.5 Investment Strategy

80**. In-house funds.** The Council's funds are mainly cash derived primarily from the General Fund and HRA. Balances are also held to support capital expenditure. From 1st April 2011, pension fund cash balances have been held separately from those of the Council. However, a separate investment strategy has not been developed for the pension fund and all its cash is held on overnight call account with RBS. Investments are made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

81**. Investment returns expectations.** Bank Rate has remained unchanged at 0.50% since March 2009 and is not forecast to rise until at least quarter 2 of 2016. Forecasts for financial year ends are:

- 2015/16 0.50%
- 2016/17 1.00%
- 2017/18 1.75%
- 2018/19 2.00%

82. As regards returns and potential returns key points made by Capita in Section 3.4 above and of prime significance in the Council's investment strategy are:

- Counterparty risks remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2015/16 and beyond.

83**. Investment treasury indicator and limit** - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. The Council's limit for investments of over 364 days is £40.5m.

84. Throughout 2015-16 to date interest rates for periods of up to 6 months have remained stable with the Council receiving about 0.75% for investments and 0.25% for the RBS Special Interest Bearing Account.

85. As a consequence of these rates and the maturity of several higher yielding investments the Council's return for the whole year is likely to be close to 0.7%. Whilst this compares well with the LIBOR benchmark and peer authorities it represents a substantial reduction from the 1% earned in 2014-15 and 1.5% earned in 2013-14.

86. As a result of the Council's strategy and the interest rates available the only counterparties actively in use during 2015-16 have been Lloyds and Royal Bank of Scotland Group, Enhanced Money Market Funds and Svenska Handelsbanken. The investment portfolio has inevitably remained concentrated with RBS and Lloyds with 80% of the total portfolio invested with them on 31st December 2015. When opportunities arise consistent with the Council's policies diversification will be sought but it is not anticipated that there will be any significant change during 2016-17.

87. Due to the low interest rates environment and uncertainties around Government funding for banks, setting expected income levels for 2016-17 and beyond is imprecise. Investment income (net of allocations and interest from West London Waste Authority) has been budgeted at £414,500 for 2016/17 (2015/16 £699,000).

4. OPTIONS CONSIDERED

88. No options were considered beyond those discussed in the report due to the statutory and risk management constraints inherent in treasury management.

5. IMPLICATIONS OF THE RECOMMENDATIONS

89. The recommendations primarily relate to the requirements for the Council to comply with statutory duties. However, the content of the report, covering borrowing and investment strategy, has implications for the Council's ability to fund its capital projects and revenue activities.

90. The recommendations do not directly affect the Council's staffing /workforce.

6. FINANCIAL IMPLICATIONS

91. Financial matters are integral to the report.

7. RISK MANAGEMENT IMPLICATIONS

92. The identification, monitoring and control of risk are central to the achievement of treasury management objectives and to this report. Potential risks are identified, mitigated and monitored in accordance with Treasury Management Practice Notes approved by the Treasury Management Group.

93. Risks are included in the Directorate Risk Register.

8. EQUALITIES IMPLICATIONS / PUBLIC SECTOR EQUALITY DUTY

94. Officers have considered possible equalities impact and consider that there is no adverse equalities impact as there is no direct impact on individuals

9. COUNCIL PRIORITIES

95. This report deals with the Treasury Management Strategy which plays a significant part in supporting the delivery of all the Council's corporate priorities.

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert Date: 18 January 2015	X	Director of Finance
Name: Caroline Eccles Date: 18 January 2015	X	on behalf of the Monitoring Officer

Ward Councillors notified:	**No**

Section 4 - Contact Details and Background Papers

Contact: Ian Talbot (Treasury and Pension Fund Manager) Tel: 020-8424-1450 / Email: ian.talbot@harrow.gov.uk

Background Papers: N/A

APPENDIX 1

LEGISLATION AND REGULATIONS IMPACTING ON TREASURY MANAGEMENT

The following items numbered 1 - 4 show the sequence of legislation and regulation impacting on the treasury management function. The sequence begins with primary legislation, moves through Government guidance and Chartered Institute of Public Finance and Accountancy (CIPFA) codes of practice and finishes with implementation through the Council's own Treasury Management Practices.

1. Local Government Act 2003

Link below

Local Government Act 2003

Below is a summary of the provisions in the Act dealing with treasury management.

In addition the Secretary of State is empowered to define the provisions through further regulations and guidance which he has subsequently done through statutory instruments, Department of Communities and Local Government Guidance and CIPFA codes of practice.

Power to borrow
The Council has the power to borrow for purposes relevant to its functions and for normal treasury management purposes – for example, to refinance existing debt.

Control of borrowing
The main borrowing control is the duty not to breach the prudential and national limits as described below.
The Council is free to seek loans from any source but is prohibited from borrowing in foreign currencies without the consent of Treasury, since adverse exchange rate movements could leave it owing more than it had borrowed.
All of the Council's revenues serve as security for its borrowing. The mortgaging of property is prohibited.
It is unlawful for the Council to 'securitise', that is, to sell future revenue streams such as housing rents for immediate lump-sums.

Affordable borrowing limit
The legislation imposes a broad duty for the Council to determine and keep under review the amount it can afford to borrow. The Secretary of State has subsequently defined this duty in more detail through the Prudential Code produced by CIPFA, which lays down the practical rules for deciding whether borrowing is affordable.

It is for the Council (at a meeting of the full Council) to set its own 'prudential' limit in accordance with these rules, subject only to the scrutiny of its external auditor. The Council is then free to borrow up to that limit without Government consent. The Council is free to vary the limit during the year, if there is good reason.

Requirements in other legislation for the Council to balance its revenue budget prevents the long-term financing of revenue expenditure by borrowing. However the legislation does confer limited capacity to borrow short-term for revenue needs in the interests of cash-flow management and forseeable requirements for temporary revenue borrowing are allowed for when borrowing limits are set by the Council.

The Council is allowed extra flexibility in the event of unforeseen needs, by being allowed to increase borrowing limits by the amounts of any payments which are due in the year but have not yet been received.

Imposition of borrowing limits
The Government has retained reserve power to impose 'longstop' limits for national economic reasons on all local authorities' borrowing and these would override authorities' self-determined prudential limits. Since this power has not yet been used the potential impact on the Council is not known.

Credit arrangements
Credit arrangements (eg property leasing, PFI and hire purchase) are treated like borrowing and the affordability assessment must take account not only of borrowing but also of credit arrangements. In addition, any national limit imposed under the reserve powers would apply to both borrowing and credit.

Power to invest
The Council has the power to invest, not only for any purpose relevant to its functions but also for the purpose of the prudential management of its financial affairs.

2. Department for Communities and Local Government Investment Guidance (March 2010)

The Local Government Act 2003 requires a local authority "…..to have regard (a) to such guidance as the Secretary of State may issue………….." and the current guidance became operative on 1 April 2010.

The Guidance recommends that for each financial year the Council should prepare at least one investment Strategy to be approved before the start of the year. The Strategy must cover:

- **Investment security**

  Investments should be managed prudently with security and liquidity being considered ahead of yield

  Potential counterparties should be recognised as "specified" and "non-specified" with investment limits being defined to reflect the status of each counterparty

- **Investment risk**

  Procedures should be established for monitoring, assessing and mitigating the risk of loss of invested sums and for ensuring that such sums are readily accessible for expenditure whenever needed.

  The use of credit ratings and other risk assessment processes should be explained

  The use of external advisers should be monitored

  The training requirements for treasury management staff should be reviewed and addressed

  Specific policies should be stated as regards borrowing money in advance of need

- **Investment Liquidity**

  The Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed

The Strategy should be approved by the full Council and made available to the public free of charge. Subject to full Council approval, or approved delegations, the Strategy can be revised during the year.

3. Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (CIPFA 2011)

The primary requirements of the Code are:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

- Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.

- Receipt by the full Council or Cabinet of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

4. The Prudential Code for Capital Finance in Local Authorities (CIPFA 2011)

Compliance with the objectives of the Code by the Council should ensure that:

- Capital expenditure plans are affordable in terms of their implications on Council Tax and housing rents
- External borrowing and other long term liabilities are within prudent and sustainable levels
- Treasury management decisions are taken in accordance with good professional practice

As part of the two codes of practice above the Council is required to:

- agree a series of prudential indicators against which performance is measured
- produce Treasury Management Practice Notes for officers which set out how treasury management policies and objectives are to be achieved and activities controlled.

APPENDIX 2

TREASURY MANAGEMENT DELEGATIONS AND RESPONSIBILITIES

The respective roles of the Cabinet, GARMCS, the Section 151 officer, the Treasury Management Group and the Treasury Team are summarised below. Further details are set out in the Treasury Management Practices.

The main responsibilities and delegations in respect of treasury activities are:

Council

Council will approve the annual treasury strategy, including borrowing and investment strategies. In doing so Council will establish and communicate their appetite for risk within treasury management having regard to the Prudential Code

Cabinet

Cabinet will recommend to Council the annual treasury strategy, including borrowing and investment strategies and receive a half-year report and annual out-turn report on treasury activities.

Cabinet also approves revenue budgets, including those for treasury activities.

Governance, Audit, Risk Management and Standards Committee

GARMSC is responsible for ensuring effective scrutiny of the Treasury strategy and policies.

Section 151 Officer

Council has delegated responsibility for the implementation and monitoring of treasury management decisions to the Section 151 Officer to act in accordance with approved policy and practices. In particular, the Sector 151 Officer:

- Approves all new borrowing, investment counterparties and limits and changes to the bank mandate,
- Chairs the Treasury Management Group (“TMG”), and
- Approves the selection of treasury advisor and agrees terms of appointment.

Treasury Management Group

Monitors the treasury activity against approved strategy, policy, practices and market conditions.

Approves changes to treasury management practices and procedures.

Reviews the performance of the treasury management function using benchmarking data on borrowing and investment provided by Sector.

Monitors the performance of the appointed treasury advisor and recommends any necessary actions.

Ensures the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.

Monitors the adequacy of internal audit reviews and the implementation of audit recommendations.

Treasury and Pension Fund Manager

Has responsibility for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Policy Statement and CIPFA's 'Standard of Professional Practice on Treasury Management'.

Treasury Team

Undertakes day to day treasury investment and borrowing activity in accordance with strategy, policy, practices and procedures and recommends changes to these to the TMG.

APPENDIX 3

Provided by Capita Asset Services at November 2015

Economic Background

UNITED KINGDOM

UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.3%.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1% in the second half of 2016. Indeed, the increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. Nevertheless, despite average weekly earnings ticking up to 3.0% y/y in the three months ending in September, this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate in the near future as labour productivity growth has meant that net labour unit costs appear to be rising by about only 1% y/y. Having said that, at the start of October, data came out that indicated annual labour cost growth had jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.

There is, therefore, considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also 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. There are, therefore, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and ‘noflation’ was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 2016 and increases after that will be at a much slower pace, and to much 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.

The Government’s revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

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, growth rebounded very strongly in Q2 to 3.9% (annualised) before dipping again in Q3 to 2.1%.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. may start to increase rates in September. However, the Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. 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 stunningly strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided since August, has now firmly opened up the possibility of a first rate rise in December.

EUROZONE

The ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in Q1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in Q2 and +0.3% in Q3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

GREECE

During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the 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.

CHINA AND 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 -0.7% after a short burst of strong growth of 1.0% during Q1. Growth in Q3 was -0.8% so Japan is now back into recession for the fourth time in five years. It has been hit hard by the downturn in China during 2015. This does not bode well for Japan as the Abe government has already fired its first two arrows to try to stimulate recovery and a rise in inflation from near zero, but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very 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 downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of the bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, concerns about whether the Chinese economy could be heading for a hard landing, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, remain a concern.

EMERGING COUNTRIES

There are also considerable concerns about the vulnerability of some emerging countries and their corporates which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries) there is now a strong flow back to those western economies with strong growth and an imminent rise in interest rates and bond yields.

This change in investors' strategy, and the massive reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US, has helped to cause the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. Capita Asset Services undertook its last review of interest rate forecasts on 9 November 2015 shortly after the publication of the quarterly Bank of England Inflation Report. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. 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. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

However, the overall balance of risks to our Bank Rate forecast 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. Market expectations in November, (based on short sterling), for the first Bank Rate increase are currently around mid-year 2016.

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 turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and 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

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.
- The commencement by the US Federal Reserve of increases in the Fed. funds 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.