Treasury Management Strategy Report 2016/17

Summary **Report for Executive to consider and recommend to Council the treasury strategy for 2016/17**

Portfolio Finance **Date Portfolio Holder signed off report: 13 January 2016**
Wards Affected All

Recommendation **The Executive is advised to RECOMMEND to Council the adoption of** **(i) The Treasury Management Strategy for 2016/17;** **(ii) The Treasury Management Indicators for 2016/17 at Annex C; and** **(iii) The Annual minimum revenue provision policy statement at Annex D.**

1. **Resource Implications**

1.1. The budget for investment income in 2016/17 is £300,000 based on an average investment portfolio of £20 million at an interest rate of 1.5%. The budget for debt interest paid in 2016/17 is £505,000, based on an average debt portfolio of £18 million at an average interest rate of 2.9%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

1.2. Funding for the proposed corporate capital programme for 2016/17 – 2018/19 will need to be paid for through borrowing or out of revenue due to the fact that the Council's pool of capital receipts is virtually exhausted.

1.3. Any changes to levels of investments and borrowing, or to the interest rates forecast in this report and which result in changes to the approved treasury management indicators will be reflected in relevant future reports for Executive and Council to consider.

2. Key Issues

2.1. Treasury Management is "the management of the Council's 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. The Council's investment portfolio comprises of funds available for longer-term investment, and short term investments sufficient to meet cash flow requirements. Investment income is a significant source of income which is used to maintain services.

2.3. On the 22nd February 2013 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

2.4. In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Council Investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

2.5. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

2.6. The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

3. Options

3.1. The Executive can receive or amend the report, or ask for further information.

3.2. The Executive can approve or amend the proposed recommendations to Council.

4. Proposals

4.1. The Executive is asked to approve and recommend to Council the adoption of:

a) The Treasury Management Strategy for 2016/17 at Annex B.

b) The Treasury Management Indicators for 2016/17 at Annex C.

c) The Annual minimum revenue provision policy statement at Annex E.

5. Supporting Information

External Context

5.1. The Council's treasury management advisors Arling Close Limited have advised us of their assessment of the external context the council’s investment strategy needs to consider in terms of the economy, interest rates and credit outlook. This is shown below:

5.2. Economic background:
Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Low oil and commodity prices were a notable feature of 2015, and contributed to annual CPI inflation falling to 0.1% in October. Wages are growing at 3% a year, and the unemployment rate has dropped to 5.4%. Mortgage approvals have risen to over 70,000 a month and annual house price growth is around 3.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England’s Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 81st consecutive month at its meeting in November 2015. Quantitative easing (QE) has been maintained at £375bn since July 2012.

5.3. The outcome of the UK general election, which was largely fought over the parties’ approach to dealing with the deficit in the public finances, saw some big shifts in the political landscape and put the key issue of the UK’s relationship with the EU at the heart of future politics. Uncertainty over the outcome of the forthcoming referendum could put downward pressure on UK GDP growth and interest rates.

5.4. China's growth has slowed and its economy is performing below expectations, reducing global demand for commodities and contributing to emerging market weakness. US domestic growth has accelerated but the globally sensitive sectors of the US economy have slowed. Strong US labour market data and other economic indicators however suggest recent global turbulence has not knocked the American recovery off course. The Federal Reserve did not raise policy rates at its meetings in October and November, but the statements accompanying the policy decisions point have made a rate hike in December 2015 a real possibility. In contrast, the European Central Bank finally embarked on QE in 2015 to counter the perils of deflation.

5.5. Credit outlook
The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK Banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government’s stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.

5.6. Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and Germany. The rest of the European Union will follow suit in January 2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain stubbornly low.

5.7. Interest rate forecast

The Authority's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.

5.8. A shallow upward path for medium term gilt yields is forecast, as continuing concerns about the Eurozone, emerging markets and other geo-political events weigh on risk appetite, while inflation expectations remain subdued. Arlingclose projects the 10 year gilt yield to rise from its current 2.0% level by around 0.3% a year. The uncertainties surrounding the timing of UK and US interest rate rises are likely to prompt short-term volatility in gilt yields.

5.9. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

5.10. For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1.5%, and that new long-term loans will be borrowed at an average rate of 3%.

Local Context

5.11. The budget for investment income for 2015/16 is £300k based on the current investment strategy and the one proposed. However this level of income is not guaranteed as it depends on the performance of the markets and the world economy.

5.12. The Council currently has £17.9m of borrowing and £38 million of investments (as at 31st December 2015) as set out in Appendix B.

5.13. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, subject to holding a minimum investment balance of £5 million. However the Council will also borrow externally if there is a sound business case for doing so.

5.14. The Council has a CFR of £19m due to the capital programme and a lack of capital receipts to finance it, which is current and will continue to be be funded by external or internal borrowing in the future.

5.15. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. The Council expects to comply with this recommendation during 2015/16.

Borrowing Strategy

5.16. The Council currently holds £17.9m of loans which were all taken out in 2015/16 as part of its strategy for funding and acquiring property. The Council expects to borrow up to £0.3m in 2016/17. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £26 million.

5.17. Objectives:

The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

5.18. Strategy:

Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With interest rates currently low the authority has fixed its borrowing for the longer term to give certainty of cost. However for future borrowings it may be more cost effective to borrow for a shorter period and then renew or to use internal resources.

5.19. In addition, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

5.20. Sources:
The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Surrey Pension Fund)
- UK Municipal Bond agency Plc, such as the LGA bond company, created to enable local Council bond issues
- Local Enterprise Partnership

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

5.21. The Council will generally raise all of its long-term borrowing from the PWLB but will continues to investigate other sources of finance, such as local Council loans and bank loans, that may be available at more favourable rates. Currently the Council has borrowed £16.4m from the PWLB and £1.5m from the LEP.

5.22. UK Municipal Bond agency Plc:

The UK Municipal Bond agency Plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for three reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local Council borrowers default on their loans; there will be a lead time of several months between committing to borrow and knowing the interest rate payable; and up to 5% of the loan proceeds will be withheld from the Council and used to bolster the Agency's capital strength instead. For these reasons it is unlikely that this will be used as a source of finance. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

5.23. Short-term and Variable Rate loans:

These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

5.24. Debt Rescheduling:

The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

5.25. Annual Minimum Revenue Provision (MRP) Statement

When a Council borrows, it is required to indicate how it intends to fulfil its duty to make prudent provision for the repayment of the capital borrowed from revenue. This provision is called the Minimum Revenue Payment or MRP. Best practice guidance recommends that Councils prepare a statement of policy on making MRP in respect of the forthcoming financial year. This statement must be submitted to full Council for approval before the start of the financial year. If it is subsequently changed it must be approved by full Council again.

5.26. The recommended policy is attached in Annex E and will be recommended for Council to approve.

5.27. The forecast MRP is shown in the table below:

	2016/17	**2017/18**	**2018/19**
	£m	**£m**	**£m**
Forecast MRP	0.202	0.453	0.458

Investment Strategy

5.28. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £15 and £30 million, and similar levels are expected to be maintained in the forthcoming year.

5.29. Objectives:

Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving unsuitably low investment income.

5.30. Strategy:

5.31. Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to remain diversified into higher yielding asset classes during 2016/17. This is especially the case for the estimated £8m that is available for longer-term investment which has been invested in to Corporate Bond, Equity and Property Funds. The remainder of the Authorities surplus cash is currently invested in short-term unsecured bank deposits, Loans to other Councils and money market funds. No changes are proposed to the 2015/16 investment strategy for 2016/17

5.32. Approved Counterparties:

The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Approved Investment Counterparties and Limits

Credit Rating	**Banks Unsecured**	**Banks Secured**	**Building Societies**	**Government**	**Corporates**	**Registered Providers**
UK Govt	n/a	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3m 5 years	£3m 10 years	£2m 3 years	n/a	£2m 20 years	£2m 10 years
AA+	£3m 3 years	£3m 10 years	£2m 3 years	n/a	£2m 10 years	£2m 10 years
AA	£3m 3 years	£3m 5 years	£2m 3 years	n/a	£2m 5 years	£2m 5 years
AA-	£3m 3 years	£3m 4 years	£2m 3 years	n/a	£2m 4 years	£2m 5 years
A+	£3m 2 years	£3m 3 years	£2m 2 years	n/a	£2m 3 years	£2m 3 years
A	£3m 12 months	£2m 2 years	£2m 12 months	n/a	£1m 2 years	£2m years
A-	£3m 6 months	£2m 12 months	£1m 6 months	n/a	£1m 12 months	£2m 1 years
BBB+	£3m 100 days	£1m 6 months	£1m 100 days	n/a	n/a	£1m 6 months
BBB or BBB-	£1m next day only	N/A	n/a	n/a	n/a	n/a
None		n/a	£1m 6 months	n/a	n/a	n/a
Pooled funds	£2m per fund					
Challenger Banks	£1m for 6 months					
Supranational Banks	£3m for up to 5 years where rated A or above					
UK Local Councils	£2m per authority for up to 5 years					

This table must be read in conjunction with the notes below

5.33. Credit Rating:

5.34. Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

5.35. Banks Unsecured:

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Authority's current account bank Natwest Bank.

5.36. Banks Secured:

Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

5.37. Building Societies

Covered Bonds, accounts and deposits with Building Societies. The Council invests with unrated building societies where independent credit analysis shows them to be suitably creditworthy. In respect of insolvency Building societies are now treated the same as banks and there are no preferential treatment for depositors.

5.38. UK Government:

Loans bonds and bills issued or guaranteed by the UK Government. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

5.39. Corporates:

5.40. Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

5.41. Registered Providers:

Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain a high likelihood of receiving government support if needed.

5.42. Challenger Banks

Loans, covered bonds and deposits placed in unrated challenger banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. The strategy has been changed on the advice of our advisors to bring the investment period in to line with unrated building societies. i.e. from £2m for 1 year to £1m for 6 months. The Council currently ahs no investments with Challenger Banks

5.43. Pooled Funds:

Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

5.44. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

5.45. Supranational Banks

Loans bonds and bills issued or guaranteed by Supranational Banks such as the European Investment Bank, European central bank etc. These investments are not subject to bail-in, and there is an insignificant risk of insolvency.

5.46. UK Local Authorities

Loans to UK local authorities and public bodies whether credit rated or not.

5.47. Risk Assessment and Credit Ratings:

Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

5.48. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

5.49. Other Information on the Security of Investments:

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. The advice of our treasury advisors will also be taken in to account. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

5.50. When deteriorating financial market conditions affect the creditworthiness of all organisations this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

5.51. Specified Investments:

The CLG Guidance defines specified investments as those:
denominated in pound sterling,

- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

5.52. The Authority defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

5.53. Non-specified Investments:

Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in the table below.

Non-Specified Investment Limits

	Cash limit
Total long-term investments	£15m
Total investments without credit ratings or rated below A-	£10m
Total investments with supranational banks domiciled in foreign countries rated below AA+	£10m
Total non-specified investments	£35m

5.54. Investment Limits:

5.55. The Authority's revenue reserves available to cover investment losses are forecast to be £15 million on 31st March 2016. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £3 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts and industry sectors as below:

Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£3m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£3m per group
Any group of pooled funds under the same management	£3m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Registered Providers	£5m in total
Unsecured investments with Building Societies	£5m in total
Loans to unrated corporates	£2m in total
Money Market Funds	£10m in total

5.56. Liquidity Management:

The Authority uses a cash flow forecasting spreadsheet to determine the maximum period for which funds may prudently be committed.

6. Other Items

6.1. There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its treasury management strategy. These are shown in Annex B

7. Treasury Management Indicators

7.1. The Council measures and manages its exposure to treasury management risks using a range of indicators which members are asked to approve. These are set out in Annex C.

8. Corporate Objectives and Key Priorities

8.1. The Treasury Management supports the Council's Key Priority 2.

9. Policy Framework

9.1. The Council fully complies with the requirements of the CIPFA Code of Practice on Treasury Management. The current relevant criteria and constraints incorporated into the Treasury Management Policy Statement are:

a. New borrowing is to be contained within the limits approved by the Council, in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities, and the Council’s prudential indicators.

b. Investments to be made in accordance with the CLG guidance on Local Council Investments, on the basis of Fitch, Moody’s and Standard & Poors credit ratings for rated institutions and as detailed in the Treasury Management Policy statement and approved schedules and practices.

c. Sufficient funds to be available to meet the Council’s estimated outgoings for any day.

d. Investment objectives are to maximise the return to the Council, subject to the overriding need to protect the capital sum.

e. The Council’s response to interest rate changes is to minimise the net interest rate burden on borrowing and maximise returns from investments, subject to (a-d) above.

10. Legal Issues

10.1. These are addressed in the report and relate to a requirement to set and agree both a treasury management strategy and prudential indicators.

11. Governance Issues

11.1. The recommendations address best practice and are required as part of the CIPFA code

12. Sustainability

12.1. None

13. Risk Management

13.1. Poor returns on investments could lead to a reduction in income required to support the revenue budget.

13.2. The limits proposed in this report in respect to counterparties and investments are the overall limits for agreement by Council. However from time to time these may be tightened temporarily by the Executive Head of Finance in consultation with the portfolio holder for Resources to reflect increased uncertainty and increase in perceived risk in financial institutions and the economy. This will usually be at the cost of lower returns.

13.3. The investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may be unable to repay its loans whatever the credit rating.

14. Consultation

14.1. The Council's treasury advisors have been consulted on the treasury strategy.

15. Officer Comments

15.1. Included within the paper.

Annexes	Annex A – Arlingclose Economic and Interest Rate Forecast October 2015 Annex B – 2016/17 Treasury Management Strategy Annex C – 2016/17 Treasury Management Indicators
Background Papers	CIPFA Code of Practice: Treasury Management in the Public Services – 2011 Edition
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Head of Service	Kelvin Menon - Executive Head of Finance

Consultations, Implications and Issues Addressed

Resources	**Required**	**Consulted**
Revenue	✓	
Capital		
Human Resources		
Asset Management		
IT		
Other Issues	**Required**	**Consulted**
Corporate Objectives & Key Priorities	✓	
Policy Framework		
Legal		
Governance		
Sustainability		
Risk Management		
Equalities Impact Assessment		
Community Safety		
Human Rights		
Consultation		
P R & Marketing		

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Arlingclose Economic & Interest Rate Forecast November 2015
Underlying assumptions:

- UK economic growth softened in Q3 2015 but remained reasonably robust; the first estimate for the quarter was 0.5% and year-on-year growth fell slightly to 2.3%. Negative construction output growth offset fairly strong services output, however survey estimates suggest upwards revisions to construction may be in the pipeline.
- Household spending has been the main driver of GDP growth through 2014 and 2015 and remains key to growth. Consumption will continue to be supported by real wage and disposable income growth.
- Annual average earnings growth was 3.0% (including bonuses) in the three months to August. Given low inflation, real earnings and income growth continue to run at relatively strong levels and could feed directly into unit labour costs and households' disposable income. Improving productivity growth should support pay growth in the medium term. The development of wage growth is one of the factors being closely monitored by the MPC.
- Business investment indicators continue to signal strong growth. However the outlook for business investment may be tempered by the looming EU referendum, increasing uncertainties surrounding global growth and recent financial market shocks.
- Inflation is currently very low and, with a further fall in commodity prices, will likely remain so over the next 12 months. The CPI rate is likely to rise towards the end of 2016.
- China's growth has slowed and its economy is performing below expectations, which in turn will dampen activity in countries with which it has close economic ties; its slowdown and emerging market weakness will reduce demand for commodities. Other possible currency interventions following China's recent devaluation will keep sterling strong against many global currencies and depress imported inflation.
- Strong US labour market data and other economic indicators suggest recent global turbulence has not knocked the American recovery off course. Although the timing of the first rise in official interest rates remains uncertain, a rate rise by the Federal Reserve seems significantly more likely in December given recent data and rhetoric by committee members.
- Longer term rates will be tempered by international uncertainties and weaker global inflation pressure.

Forecast:

- Arlingclose forecasts the first rise in UK Bank Rate in Q3 2016. Further weakness in inflation, and the MPC's expectations for its path, suggest policy tightening will be pushed back into the second half of the year. Risks remain weighted to the downside. Arlingclose projects a slow rise in Bank Rate, the appropriate level of which will be lower than the previous norm and will be between 2 and 3%.
- The projection is for a shallow upward path for medium term gilt yields, with continuing concerns about the Eurozone, emerging markets and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued.
- The uncertainties surrounding the timing of UK and US monetary policy tightening, and global growth weakness, are likely to prompt short term volatility in gilt yields.

	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
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50
Arlingclose Central Case	**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**
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.25	-1.25
3-month LIBID rate													
Upside risk	0.20	0.30	0.30	0.30	0.35	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**0.55**	**0.60**	**0.70**	**0.80**	**0.95**	**1.05**	**1.15**	**1.30**	**1.40**	**1.55**	**1.65**	**1.80**	**1.85**
Downside risk		-0.20	-0.30	-0.45	-0.55	-0.65	-0.80	-0.90	-1.05	-1.10	-1.20	-1.20	-1.20
1-yr LIBID rate													
Upside risk	0.25	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.45
Arlingclose Central Case	**1.10**	**1.20**	**1.35**	**1.45**	**1.55**	**1.70**	**1.80**	**1.95**	**2.00**	**2.10**	**2.15**	**2.15**	**2.15**
Downside risk	-0.15	-0.25	-0.35	-0.50	-0.60	-0.70	-0.85	-0.95	-1.10	-1.15	-1.25	-1.25	-1.25
5-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	**1.50**	**1.55**	**1.60**	**1.70**	**1.80**	**1.90**	**2.00**	**2.10**	**2.20**	**2.25**	**2.30**	**2.35**	**2.35**
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
10-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	**2.00**	**2.05**	**2.10**	**2.20**	**2.30**	**2.40**	**2.50**	**2.60**	**2.65**	**2.70**	**2.75**	**2.80**	**2.80**
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
20-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	**2.45**	**2.50**	**2.55**	**2.55**	**2.60**	**2.65**	**2.70**	**2.75**	**2.80**	**2.85**	**2.90**	**2.95**	**2.95**
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.65	-0.75	-0.85	-0.95	-1.05	-1.10	-1.15	-1.20	-1.20
50-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	**2.45**	**2.50**	**2.55**	**2.60**	**2.65**	**2.70**	**2.75**	**2.80**	**2.85**	**2.90**	**2.95**	**3.00**	**3.00**
Downside risk	-0.25	-0.35	-0.45	-0.50	-0.60	-0.70	-0.80	-0.90	-1.00	-1.05	-1.10	-1.15	-1.15

Other Items

There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

1. **Policy on Use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

   The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives including those present in pooled funds and forward starting transactions will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

   Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

2. **Investment Training:** The needs of the Council's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

   Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

3. **Investment Advisers:** The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

4. **Investment of Money Borrowed in Advance of Need**: The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening

period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £26million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

5. **Other Options Considered** :The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Portfolio Member believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	**Impact on income and expenditure**	**Impact on risk management**
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Reduced risk of losses from credit related defaults
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

Annex C

Treasury Management Indicators for 2016/17

1. The Council measures its exposures to treasury management risks using the following indicators. The Council is asked to approve the following indicators:

2. Security: average credit rating

   The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio.

	Target
Portfolio average credit rating	A

   This is calculated by applying a score to each investment (AAA=1, AA+=2 etc.) and taking the arithmetic average weighted by the size of each investment. For the purpose of this indicator, unrated building societies are assigned an indicative rating of BBB, and unrated local authorities are assumed to hold a AA+ rating.

3. Liquidity: cash available within three months

   The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period.

	Target
Total cash available within 3 months	£5m

4. Interest rate exposures

   This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2016/17	2017/18	2018/19
Upper limit on fixed interest rate exposures	£26m	£26m	£26m
Upper limit on variable interest rate exposures	£26m	£26m	£26m

   Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date of later. All other instruments are classed as variable rate.

5. Maturity structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within five years	100%	0%
Five years and within 10 years	100%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

6. Principal sums invested for periods longer than 364 days

7. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long term principal sum invested to final maturities beyond the period end will be:

	2016/17	2017/18	2018/19
Limit on principal invested beyond year end	£15m	£15m	£15m

8. Borrowing limits

The Council is being asked to approve these Prudential Indicators as part of the capital programme report. However they are repeated here for completeness.

The Council is required to set two Prudential Indicators for external debt:

- the Operational Boundary – estimate of most likely scenario for external debt.

- The Authorised Limit – represents the limit beyond which external debt is prohibited. It is a statutory limit set under S3(1) of the Local Government Act 2003.

	2016/17	2017/18	2018/19
Operational boundary – borrowing	£22m	£22m	£22m
Operational boundary – other long-term liabilities	£2m	£2m	£2m
Operational boundary – TOTAL	**£24.0m**	**£24.0m**	**£24.0m**
Authorised limit – borrowing	£24m	£24m	£24m
Authorised limit – borrowing & long-term liabilities	£2m	£2m	£2m

Authorised limit – TOTAL	**£26m**	**£26m**	**£26m**

Any borrowing required for a specific project would need separate approval. This prudential indicator would need to be adjusted accordingly and approval sought from Council to increase the limit.

Annex C

List of Investments and Borrowings as at the 31st December 2015

Investments

		Maturity Date	
Lloyds Bank Call Account	3,003,773	Instant Access	A+
Goldman Sachs Bank	2,000,000	11-Dec-15	A
Total Banks	**5,003,773**		
Debt Management Office	**0**		
Coventry Building Society	2,000,000	02-Mar-16	A
Cumberland Building Society	1,000,000	10-Feb-06	
National Counties Building Society	1,000,000	04-Apr-16	
Nationwide Building Society	2,000,000	08-Apr-16	A
Total Building Society	**6,000,000**		
Icelandic Banks	676,779	In Receivership	
Total Banks, Building Societies and DMO	**11,680,552**		
Glasgow City Council	2,000,000	30-Oct-18	Unrated
Greater London Authority	2,000,000	28-Oct-16	AA+
Lancashire County Council	1,500,000	30-Sep-16	Unrated
The London Borough of Islington	2,000,000	28-Oct-16	Unrated
Total Local Authorities	**7,500,000**		
AAA Rated MM Fund - Aberdeen (SWIP)	2,959,304	N/A	AAA
AAA Rated MM Fund - Blackrock	2,000,000	N/A	AAA
AAA Rated MM Fund - CCLA	1,000,000	N/A	AAA
AAA Rated MM Fund - Insight	1,003,614	N/A	AAA
AAA Rated MM Fund - Standard Life (Ignis)	3,000,000	N/A	AAA
Total Money Market Funds	**9,962,918**		
CCLA Property Fund	2,109,679	N/A	None
M & G Investments - Global Dividend Fund	896,091	N/A	None
M & G Investments - Strategic Corp Bond Fund	1,976,758	N/A	None
Threadneedle - Global Equity Income Fund	1,005,130	N/A	None
Threadneedle - Strategic Bond Fund	1,960,618	N/A	None
Total Longer Term Investments	**7,948,276**		
Total Invested (excluding the NatWest SIBA)	**37,091,747**		
NatWest SIBA	1,517,012	Instant Access	BBB+
Total Invested (including NatWest SIBA)	**38,608,759**		
War Stock	13		
Total Invested (Including SIBA & War Stock)	**38,608,772**		

Annex C

Borrowings

Date loan taken out	Capital Borrowed	Lender	Period of Loan	Interest rate	Fixed/Variable
21/04/15	£1.5m	M3 LEP	5 years	0%	Fixed
21/04/15	£8.4m	PWLB	50 years	3.16%	Fixed
24/06/15	£6m	PWLB	50 Years	3.44%	Fixed
24/06/15	£2m	PWLB	5 Years	2.11%	Fixed

Annex D

Proposed Minimum Revenue Policy (MRP) Statement

1. The Secretary of State under section 21(1A) of the Local Government Act 2003 issued guidance on the calculation of MRP in February 2008 with 2008/09 being the first year of operation. The Council has assessed its method of MRP and is satisfied that the guidelines for its annual amount of MRP set out within this policy statement will result in its making the prudent provision that is required by the guidance.

2. For capital expenditure incurred and funded through borrowing the Council will calculate MRP using the asset life method as summarised in the table below. MRP will be based on the estimated life of the assets purchased by unsupported borrowing.

Estimated economic lives of assets

Asset Class	Estimated economic life
Land and heritage assets	50 years
Buildings for services	40 years
Vehicles and Plant	10 years
IT equipment and software	5 years
Investment property and property for regeneration	0% to 1% depending on change in value

3. The Council will aim to minimise the impact of MRP on the General Fund by funding assets with a longer economic life from borrowing in the first instance.

4. In accordance with provisions in the guidance MRP will be charged in the year following the date an asset becomes operational.

5. MRP may not be made on investment properties where they increase in value as the asset could be sold to repay any outstanding debt.

6. The Council reserves the right to determine alternative MRP approaches in particular cases in the interests of making prudent provision where this is material, taking in to account local circumstances, including specific project timetables and revenue earning profiles.