Annual Report on the Treasury Management Service and Actual Prudential Indicators for 2015/16

SUMMARY
Report to advise members of the Treasury Management Service performance and to illustrate the compliance with the Prudential Indicators for 2015/16

PORTFOLIO	**Finance** **Councillor Richard Brooks**	**Date signed off:** **24 August 2016**
WARDS AFFECTED	**All**	

RECOMMENDATION

The Executive is asked to:

(i) NOTE the report on Treasury Management including compliance with the 2015/16 Prudential Indicators;

(ii) RECOMMEND to Full Council to NOTE compliance with the Prudential Indicators for 2015/16;

(iii) RECOMMEND to Full Council the Investment Limits for "Any Group of Pooled Funds under the same Management" in the 2016/17 Treasury Strategy be changed from £3m to £5m

1. Resource Implications

1.1 None directly as a result of this paper, but the Council is heavily dependant on investment income to support its current revenue expenditure. Investment returns have fallen significantly over recent years. The table below shows investment income from treasury activities (excluding Iceland) from 2010/11 to 2015/16.

1.2

Year	Investment income from treasury activities	Increase/decrease compared to previous year	
	£'000	£'000	%
2010/11	264	-260	-49.60%
2011/12	215	-49	-18.60%
2012/13	300	85	39.50%
2013/14	208	-92	-42.80%
2014/15	273	35	17.00%
2015/16	515	242	88.80%

1.3 Treasury income returns improved in 2015/16 following a change in investment policy in 2014/15 which enabled investment in a more diversified portfolio.

2. Key Issues

2.1 The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. This report informs members of the outcome of treasury activities in the last year and a further report later in the year will report on the first 6 months.

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

2.3 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. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management strategy.

2.4 This report is the annual report for the 2015/16 financial year. It includes both a summary of treasury management performance during the year as well demonstrating compliance with the 2015/16 Prudential Indicators.

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 Department for Communities and Local Government (DCLG) Investment Guidance, and the CIPFA Prudential Code for Capital Finance in Local Authorities.

2.6 This is the first year that the Council borrowed externally to purchase property and the impact of this is included within this report.

3. Options

3.1 The Executive can endorse, amend or reject the recommendations made.

4. Proposals

4.1 It is PROPOSED that the Executive:

(i) NOTE the report on Treasury Management including compliance with the 2015/16 Prudential Indicators;

(ii) RECOMMEND to Full Council to NOTE compliance with the Prudential Indicators for 2015/16;

(iii) RECOMMEND to Full Council the Investment Limits for “Any Group of Pooled Funds under the same Management” in the 2016/17 Treasury Strategy be changed from £3m to £5m.

5. Supporting Information

Treasury Management Strategy 2015/16

5.1 The Council approved the 2015/16 Treasury Management Strategy, which includes the investment strategy, at its meeting on the 25th February 2015. All treasury management activity complied with the approved treasury management strategy, the CIPFA Code of Practice and the relevant legislative provisions.

Investment Strategy 2015/16

5.2 The approved investment strategy for 2015/16 adopted a view to investment that sought to balance risk against return. It maintained a policy, on the advice of our treasury advisors Arlingclose, of diversifying investments including longer term investment funds which give a good return but can be more volatile.

5.3 The Council continued to use a limited range of UK banks and building societies with investments being placed generally for short periods only. This was not only because of the poor rates offered but also the risk of bail in due to changes in legislation in 2015.

5.4 In addition the Council lent money to other local authorities during the year in order to secure better returns.

Borrowing Strategy 2015/16

5.5 The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2016 was £18.1m (£1.567m at 31 March 2015) and for the first time this year the Council borrowed externally.

5.6 The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. This has meant that the borrowing entered in to this year has been at a fixed rate and long term.

Treasury Advisors

5.7 The Council uses Arlingclose Limited as its treasury management advisors to provide advice on all aspects of treasury management including interest rate forecasts, counterparty lists and management advice. They have provided an Economic Review, counterparty update and market data by way of background information and this is included in Annex C.

<u>Borrowing and Investment Activity in 2015/16</u>

Borrowing Activity 2015/16

5.8 At 31/03/2016 the Authority's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £18.1m, while usable reserves and working capital which are the underlying resources available for investment were £20.4m on an accruals basis.

5.9 At 31/03/2016, the Authority had £17.9m of borrowing and £27.7m of investments. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, subject to holding a minimum short-term investment balance of £5m.

5.10 The Authority is predicted to have an increasing CFR over the next 3 years due to the capital programme of up to £1m however this could increase significantly if further investment in property is undertaken.

5.11 During the year the Council entered in to £17.9m of new borrowing. The details are given in the table below:

Lendor	Start Date	Length of Loan (Yrs)	Int Rate	Amount Borrowed
EM3 LEP	21-Apr-15	5	0.00%	1,500,000
PWLB	23-Apr-15	50	3.16%	8,400,000
PWLB	26-Jun-15	50	3.44%	6,000,000
PWLB	26-Jun-15	5	2.11%	2,000,000
		TOTAL DEBT		**£17,900,000**

Investment Activity 2015/16

5.12 The Authority held invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2015/16 the Authority's investment balances have ranged between £22million and £39million. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Authority's aim is to achieve a yield commensurate with these principles.

5.13 The table below shows a summary of the investment activity for 2015/16:

Investment Counterparty	Balance on 1/4/15	Investments Made	Maturities/Investments Sold	Balance on 31/3/16	Average Rate at 31st March
	£000s	£000s	£000s	£000s	%
UK Central Government					
- Short Term	**0**	63,700	-63,700	**0**	0.25
- Long Term	**0**	0	0	**0**	-
UK Local Authorities					
- Short Term	**2,000**	5,500	-2,000	**5,500**	0.93
- Long Term	**3,500**	2,000	-3,500	**2,000**	1.30
Banks, Building Societies & Other Organisations					
- Short Term	**2,816**	74,657	-72,214	**5,259**	0.55
- Long Term	**0**	0	0	**0**	-
AAA-rated Money Market Funds					
- Short Term Cash Equivalents	**6,447**	18,029	-17,504	6,973	0.51
- Long Term	**8,123**		-161	7,962	3.89
Total Investments	**22,886**	**163,886**	**-159,078**	**27,693**	

5.14 Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2015/16.

5.15 Counterparty credit quality was assessed and monitored by our advisors with reference to credit ratings (the Authority's minimum long-term counterparty rating is A- across rating agencies Fitch, S&P and Moody's).

5.16 Investments during the year included:

- Deposits with the Debt Management Office
- Deposits with Other Local Authorities
- Investments in AAA-rated constant and variable net asset value Money Market Funds
- Call accounts and deposits with Banks and Building Societies in the UK
- Other Pooled funds

5.17 The Council's current accounts, together with a Special Interest Bearing Account are held with NatWest plc who do not currently meet the above credit rating criteria. The Council will treat NatWest plc as “high credit quality” for the purpose of making investments that can be withdrawn on the next working day.

Credit Risk

5.18 Counterparty credit quality as measured by credit ratings is summarised below:

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2015	3.74	AA-	2.79	AA
30/06/2015	4.03	AA-	2.72	AA
30/09/2015	4.07	AA-	2.54	AA
31/12/2015	4.75	A+	2.92	AA
31/03/2016	4.26	AA-	2.35	AA+

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Budgeted Income and Outturn

5.19 The average cash balances were £31m during the year. The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates have remained at relatively low levels. New deposits were made at an average rate of 1.2%. Investments in Money Market Funds generated an average rate of 0.5%.

5.20 The Authority’s budgeted investment income for the year was £0.3m. The Authority’s investment outturn for the year was £0.5m.

Externally Managed Funds

5.21 The Authority also has investments in strategic bond, equity and property funds which allow the Authority to diversify into asset classes other than cash with the need to own and manage the underlying investments. The funds which are operated on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short-term. All of the Authority's pooled fund investments are in the respective fund's distributing share class which pay out the income generated.

5.22 Although money can be redeemed from the pooled funds at short notice, the Authority's intention is to hold them for the medium-term. Their performance and suitability in meeting the Authority's investment objectives are monitored regularly and discussed with Arlingclose.

<u>Update on Investments with Icelandic Banks</u>

5.23 On the 31st March 2016 the council held ISK135,575,101 which represented the remainder of the council's claim against Glitnir Bank. This was subject to exchange controls imposed by the Icelandic government. However in June 2016 the Icelandic Government announced that they would allow foreign deposits to be exchanged for one last time. If this opportunity was not taken then the money would be frozen for several more years and earn no interest. As a result of this the Council took advantage of the offer and hence no money is now held in Iceland.

<u>Compliance with Prudential indicators</u>

5.24 The Council can confirm that it has complied with its Prudential Indicators for 2015/16, which were approved on 25th February 2015 by Full Council as part of the Council's Treasury Management Strategy Statement. Full details are included in Annex C.

5.25 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2015/16. None of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

5.26 There was only one breach of the Treasury Strategy during the year as follows:

On 2nd November 2015 £1m was invested with Cumberland Building Society. The limit on Building society investments was assumed 10% of total investments rather than £5m so this limit was exceeded. The money was repaid on the 10th February 2016 and the Council suffered no loss. Procedures have been changed to prevent this happening again in the future.

6. Change to 2016/17 Treasury Strategy

6.1 Following discussions with our Treasury advisors Arlingclose they have recommended that the Council makes a change to its Treasury Strategy to enable it to place more of its funds with a single fund manager. At the moment there is a limit of £3m per manager in "Any group of pooled funds under the same management". It is recommended that this be increased to £5m. This will enable the council to take advantage of funds that perform well.

7. Corporate Objectives And Key Priorities

7.1 This report demonstrates how treasury management supports Key priority 2.

8. Policy Framework

8.1 The 2015/16 Annual Investment Strategy together with the Treasury Management Strategy was approved by Full Council on the 25th February 2015. These set out the parameters under which Treasury Management operates including the Prudential Indicators.

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

- New borrowing is 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.

- Investments are made in accordance with the CLG guidance on Local Authority Investments, on the basis of Fitch, Moody's and Standard & Poors credit ratings and as detailed in the Treasury Management Policy statement and approved schedules and practices.

- Sufficient funds are available to meet the Council's estimated outgoings for any day.

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

9. Legal Issues

9.1 The Council is required to comply with the Prudential code as laid down by Government.

10. Risk Management

10.1 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. The key treasury risks being managed are:

- credit risk,
- liquidity risk,
- interest rate risk,
- refinancing risk, and
- operational risk.

The techniques employed to manage these risks are covered in detail in the Council's Treasury Management Practices, and include:

- robust counterparty monitoring and selection criteria,
- prudent cash flow forecasting,
- a range of exposure limits and indicators, and
- procedures designed to prevent fraud and error.

10.2 The Council's primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return.

10.3 The limits applied in respect of counterparties and investments are the overall limits approved by Council in the annual Treasury Management Strategy. However from time to time these may be tightened temporarily by the Executive Head of Finance in consultation with the Portfolio Holder for Finance 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.

10.4 It should be noted that 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

10.5 The Council measures its exposures to treasury management risks using a range of indicators as recommended by the CIPFA Code of Practice on Treasury Management.

11. Officer Comments

Annexes	Annex A – Investments as at 31st March 2016 Annex B - Compliance with Prudential Indicators Annex C – Economic and other background information from Arlingclose Limited.
Background Papers	Prudential Code for Capital Finance in Local Authorities
Author/Contact Details	**Kelvin Menon – Executive Head of Finance**
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		

Review Date:

Version:

Annex A

Treasury Related Investment Balances as at 31st March 2016				
Investments	**Notes**	**Maturity Date**	**Interest Rate %**	**Principal**
				£
Cash Equivalents				
NatWest Special Interest Bearing Account	On call		0.25	1,456,672
Available for Sale				
AAA Rated Fund - Standard Life	Instant Access		variable	3,000,000
Fixed Term Investments under three months				
National Counties Building Society		04-Apr-16	0.75	1,000,000
Nationwide Building Society		08-Apr-16	0.66	2,000,000
Total Cash Equivalents				**7,456,672**
Short Term Investments				
Available for Sale				
AAA Rated MM Fund - Aberdeen (SWIP)	3 Day Notice		variable	2,966,626
AAA Rated MM Fund - Insight	4 Day Notice		variable	1,005,923
Loans and Receivables				
Icelandic Banks	Updated annually as at 31st March		4.20	801,901
Greater London Authority		28-Oct-16	0.55	2,000,000
Lancashire County Council		30-Sep-16	1.10	1,500,000
The London Borough of Islington		28-Oct-16	1.15	2,000,000
Total Short Term Investmetns				**10,274,450**
Long Term Investments				
Available for Sale				
CCLA Property Fund			4.77	2,086,238
M & G Investments - Global Dividend Fund			3.23	931,883
M & G Investments - Strategic Corp Bond Fund			3.29	1,976,256
Threadneedle - Global Equity Income Fund			3.71	1,041,965
Threadneedle - Strategic Bond Fund			4.44	1,925,765
Loans and Receivables				
Glasgow City Council		30-Oct-18	1.30	2,000,000
Total Long Term Investments				**9,962,107**
Total Investments				**27,693,228**

Compliance with Prudential Indicators

The Authority confirms compliance with its Prudential Indicators for 2015/16, which were set in February 2015.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

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

	2015/16	2016/17	2017/18
Upper limit on fixed interest rate exposure	£20m	£20m	£20m
Actual	£0.3m		
Upper limit on variable interest rate exposure	£0	£0	£0
Actual	-£0.4m		

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

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

	Upper	Lower	Actual
Under 12 months	100%	0%	3%
12 months and within 24 months	100%	0%	2%
24 months and within 5 years	100%	0%	18%
5 years and within 10 years	100%	0%	4%
10 years and within 20 years	100%	0%	11%
20 years and within 30 years	100%	0%	15%
30 years and within 40 years	100%	0%	20%
Over 40 years	100%	0%	27%

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.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2015/16	2016/17	2017/18
Limit on principal invested beyond year end	£15m	£15m	£15m
Actual	£2m		

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average [credit rating] or [credit score] of its investment portfolio. 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.

	Target	Actual
Portfolio average credit rating	A	AA-

Liquidity: The Authority 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, without additional borrowing. The Authority also has the option to borrow on a daily basis on the open market.

	Target	Actual
Total cash available within 3 months	£5m	£8m

Prudential Indicators 2015/16

The Local Government Act 2003 requires the Authority to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Authority's planned capital expenditure and financing may be summarised as follows:

Capital Expenditure and Financing	2015/16 Actual	2016/17 Estimate	2017/18 Estimate
	£m	£m	£m
Capital Program	**18**	**1**	**1**
Funded by:			
Capital Receipts	1	0	0
Government Grants	0	0	0
Reserves	0	0	0
Revenue	0	0	0
Borrowing	17	1	0
Leasing and PFI	0	0	0

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

	31.03.16 Actual £m	**31.03.17 Estimate £m**	**31.03.18 Estimate £m**
Capital Financing Requirement	**18**	**19**	**20**

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31.03.16 Actual £m	31.03.17 Estimate £m	31.03.18 Estimate £m
Borrowing	17.9	17.9	17.9
Finance leases	0	0	0
PFI liabilities	0	0	0
Total Debt	18	17.9	17.9

The figures above could increase significantly if the councils decides to invest in more property.

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary	2015/16 £m	2016/17 £m	2017/18 £m
Borrowing	22	22	22
Other long-term liabilities	2	2	2
Total Debt	**24**	**24**	**24**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2015/16 £m	2016/17 £m	2017/18 £m
Borrowing	24	24	24
Other long-term liabilities	2	2	2

Total Debt	**26**	**26**	**26**

Should the Council decide to borrow to invest in property members would be asked to increase the limits above at that time.

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	**2015/16 Actual %**	**2016/17 Estimate %**	**2017/18 Estimate %**
General Fund	**-0.12**	**4.29**	**7.20**

Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed earlier in this report.

Incremental Impact of Capital Investment Decisions	**2015/16 Estimate £**	**2016/17 Estimate £**	**2017/18 Estimate £**
General Fund - increase in annual Band D Council Tax	**8.16**	11.46	6.63

Adoption of the CIPFA Treasury Management Code:
The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 26th February 2014.

ECONOMIC REVIEW, COUTERPARTY UPDATE AND MARKET DATA PROVIDED BY ARLINGCLOSE LIMITED

Economic Review

Growth, Inflation, Employment: The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3.0% the year before. CPI inflation hovered around 0.0% through 2015 with deflationary spells in April, September and October. The prolonged spell of low inflation was attributed to the continued collapse in the price of oil from $67 a barrel in May 2015 to just under $28 a barrel in January 2016, the appreciation of sterling since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued unit labour costs. CPI picked up to 0.3% year/year in February, but this was still well below the Bank of England's 2% inflation target. The labour market continued to improve through 2015 and in Q1 2016, the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and the unemployment rate at a 12 year low of 5.1%. Wage growth has however remained modest at around 2.2% excluding bonuses, but after a long period of negative real wage growth (i.e. after inflation) real earnings were positive and growing at their fastest rate in eight years, boosting consumers' spending power.

Global influences: The slowdown in the Chinese economy became the largest threat to the South East Asian region, particularly on economies with a large trade dependency on China and also to prospects for global growth as a whole. The effect of the Chinese authorities' intervention in their currency and equity markets was temporary and led to high market volatility as a consequence. There were falls in prices of equities and risky assets and a widening in corporate credit spreads. As the global economy entered 2016 there was high uncertainty about growth, the outcome of the US presidential election and the consequences of June's referendum on whether the UK is to remain in the EU. Between February and March 2016 sterling had depreciated by around 3%, a significant proportion of the decline reflecting the uncertainty surrounding the referendum result.

UK Monetary Policy: The Bank of England's MPC (Monetary Policy Committee) made no change to policy, maintaining the Bank Rate at 0.5% (in March it entered its eighth year at 0.5%) and asset purchases (Quantitative Easing) at £375bn. In its *Inflation Reports* and monthly monetary policy meeting minutes, the Bank was at pains to stress and reiterate that when interest rates do begin to rise they were expected to do so more gradually and to a lower level than in recent cycles.

Improvement in household spending, business fixed investment, a strong housing sector and solid employment gains in the US allowed the Federal Reserve to raise rates in December 2015 for the first time in nine years to take the new Federal funds range to 0.25%-0.50%. Despite signalling four further rate hikes in 2016, the Fed chose not to increase rates further in Q1 and markets pared back expectations to no more than two further hikes this year.

However central bankers in the Eurozone, Switzerland, Sweden and Japan were forced to take policy rates into negative territory. The European Central Bank also announced a range of measures to inject sustained economic recovery and boost domestic inflation which included an increase in asset purchases (Quantitative Easing).

Market reaction: From June 2015 gilt yields were driven lower by the a weakening in Chinese growth, the knock-on effects of the fall in its stock market, the continuing fall in the price of oil and commodities and acceptance of diminishing effectiveness of central bankers' unconventional policy actions. Added to this was the heightened uncertainty surrounding the outcome of the UK referendum on its continued membership of the EU as well as the US presidential elections which culminated in a significant volatility and in equities and corporate bond yields.

10-year gilt yields moved from 1.58% on 31/03/2015 to a high of 2.19% in June before falling back and ending the financial year at 1.42%. The pattern for 20-year gilts was similar, the yield rose from 2.15% in March 2015 to a high of 2.71% in June before falling back to 2.14% in March 2016. The FTSE All Share Index fell 7.3% from 3664 to 3395 and the MSCI World Index fell 5.3% from 1741 to 1648 over the 12 months to 31 March 2016.

Counterparty Update

The transposition of two European Union directives into UK legislation placed the burden of rescuing failing EU banks disproportionately onto unsecured institutional investors which include local authorities and pension funds. During the year, all three credit ratings agencies reviewed their ratings to reflect the loss of government support for most financial institutions and the potential for loss given default as a result of new bail-in regimes in many countries. Despite reductions in government support many institutions saw upgrades due to an improvement in their underlying strength and an assessment that that the level of loss given default is low.

Fitch reviewed the credit ratings of multiple institutions in May. Most UK banks had their support rating revised from 1 (denoting an extremely high probability of support) to 5 (denoting external support cannot be relied upon). This resulted in the downgrade of the long-term ratings of Royal Bank of Scotland (RBS), Deutsche Bank, Bank Nederlandse Gemeeten and ING. JP Morgan Chase and the Lloyds Banking Group however both received one notch upgrades.

Moody's concluded its review in June and upgraded the long-term ratings of Close Brothers, Standard Chartered Bank, ING Bank, Goldman Sachs International, HSBC, RBS, Coventry Building Society, Leeds Building Society, Nationwide Building Society, Svenska Handelsbanken and Landesbank Hessen-Thuringen.

S&P revised the outlook of the UK as a whole to negative from stable, citing concerns around the referendum on EU membership and its effect on the economy.

At the end of July 2015, Arlingclose advised an extension of recommended durations for unsecured investments in certain UK and European institutions following improvements in the global economic situation and the receding threat of another Eurozone crisis. A similar extension was advised for some non-European banks in September, with the Danish Danske Bank being added as a new recommended counterparty and certain non-rated UK building societies also being extended.

In December the Bank of England released the results of its latest stress tests on the seven largest UK banks and building societies which showed that the Royal Bank of Scotland and Standard Chartered Bank were the weakest performers. However, the regulator did not require either bank to submit revised capital plans, since both firms had already improved their ratios over the year.

The first quarter of 2016 was characterised by financial market volatility and a weakening outlook for global economic growth. In March 2016, following the publication of many banks' 2015 full-year results, Arlingclose advised the suspension of Deutsche Bank and Standard Chartered Bank from the counterparty list for unsecured investments. Both banks recorded large losses and despite improving capital adequacy this will call 2016 performance into question, especially if market volatility continues. Standard Chartered had seen various rating actions taken against it by the rating agencies and a rising CDS level throughout the year. Arlingclose will continue to monitor both banks.

The end of bank bail-outs, the introduction of bail-ins, and the preference being given to large numbers of depositors other than local authorities means that the risks of making unsecured deposits continues to be elevated relative to other investment options. The Authority therefore increasingly favoured secured investment options or diversified alternatives such as non-bank investments and pooled funds over unsecured bank and building society deposits.

Money Market Data and PWLB Rates

The average, low and high rates correspond to the rates during the financial year rather than those in the tables below.Please note that the PWLB rates below are Standard Rates. Authorities eligible for the Certainty Rate can borrow at a 0.20% reduction.

Table 1: Bank Rate, Money Market Rates

Date		Bank Rate		O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/04/2015		0.50		0.35	0.46	0.43	0.51	0.76	0.97	0.87	1.05	1.32
30/04/2015		0.50		0.35	0.48	0.43	0.52	0.74	0.98	1.00	1.21	1.51

31/05/2015		0.50		0.43	0.50	0.43	0.52	0.75	0.98	0.97	1.18	1.49
30/06/2015		0.50		0.35	0.45	0.43	0.52	0.79	0.99	1.09	1.35	1.68
31/07/2015		0.50		0.32	0.43	0.43	0.53	0.79	1.01	1.10	1.33	1.66
31/08/2015		0.50		0.42	0.40	0.43	0.54	0.82	1.02	1.03	1.24	1.61
30/09/2015		0.50		0.37	0.41	0.43	0.54	0.74	1.00	0.93	1.11	1.41
31/10/2015		0.50		0.36	0.41	0.43	0.54	0.77	1.00	0.97	1.16	1.49
30/11/2015		0.50		0.30	0.42	0.43	0.54	0.88	1.00	0.93	1.10	1.39
31/12/2015		0.50		0.43	0.35	0.43	0.54	0.76	1.01	1.09	1.30	1.58
31/01/2016		0.50		0.43	0.42	0.43	0.54	0.71	0.99	0.77	0.89	1.14
29/02/2016		0.50		0.25	0.43	0.43	0.54	0.73	0.99	0.71	0.74	0.85
31/03/2016		0.50		0.30	0.44	0.52	0.62	0.71	0.93	0.79	0.84	1.00
Average		**0.50**		**0.38**	**0.45**	**0.43**	**0.54**	**0.76**	**0.99**	**0.96**	**1.14**	**1.43**
Maximum		**0.50**		**0.48**	**0.58**	**0.57**	**0.66**	**0.92**	**1.02**	**1.17**	**1.44**	**1.81**
Minimum		**0.50**		**0.17**	**0.35**	**0.43**	**0.51**	**0.55**	**0.84**	**0.68**	**0.73**	**0.85**
Spread		**--**		**0.31**	**0.23**	**0.14**	**0.15**	**0.37**	**0.18**	**0.49**	**0.71**	**0.96**

Table 2: PWLB Borrowing Rates – Fixed Rate, Maturity Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2015	127/15	1.33	2.10	2.69	3.24	3.37	3.32	3.31
30/04/2015	166/15	1.41	2.27	2.90	3.44	3.55	3.50	3.48
31/05/2015	204/15	1.44	2.26	2.90	3.44	3.54	3.48	3.45
30/06/2015	248/15	1.48	2.44	3.13	3.65	3.72	3.64	3.60
31/07/2015	294/15	1.54	2.45	3.07	3.56	3.62	3.54	3.49
31/08/2015	334/15	1.47	2.30	2.92	3.47	3.54	3.44	3.40
30/09/2015	379/15	1.44	2.19	2.79	3.42	3.50	3.42	3.39
31/10/2015	423/15	1.44	2.38	2.93	3.56	3.65	3.56	3.53
30/11/2015	465/15	1.42	2.23	2.85	3.48	3.54	3.42	3.39
31/12/2015	505/15	1.41	2.38	3.01	3.61	3.68	3.56	3.53
31/01/2016	040/16	1.24	1.96	2.62	3.28	3.37	3.23	3.20
29/02/2016	082/16	1.27	1.73	2.43	3.23	3.36	3.24	3.19
31/03/2016	124/16	1.33	1.81	2.48	3.21	3.30	3.16	3.12
	Low	1.21	1.67	2.30	3.06	3.17	3.05	3.01
	Average	1.41	2.20	2.85	3.46	3.54	3.45	3.42
	High	1.55	2.55	3.26	3.79	3.87	3.80	3.78

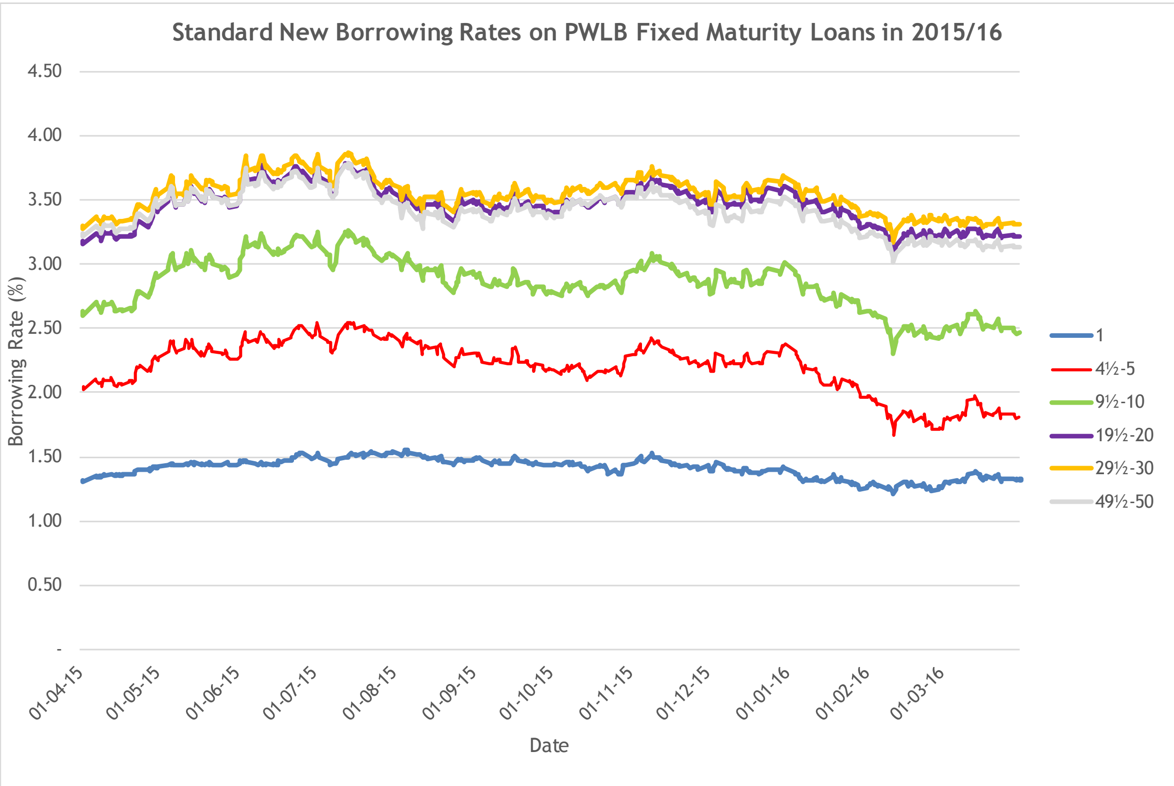

Table 3: PWLB Borrowing Rates – Fixed Rate, Equal Instalment of Principal (EIP) Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2015	127/15	1.66	2.14	2.71	3.03	3.24	3.35
30/04/2015	166/15	1.79	2.31	2.92	3.24	3.45	3.54
31/05/2015	204/15	1.78	2.30	2.93	3.26	3.45	3.53
30/06/2015	248/15	1.90	2.49	3.15	3.47	3.65	3.72
31/07/2015	294/15	1.96	2.50	3.09	3.39	3.57	3.63
31/08/2015	334/15	1.83	2.34	2.94	3.27	3.48	3.55
30/09/2015	379/15	1.76	2.23	2.82	3.19	3.43	3.51
31/10/2015	423/15	1.81	2.32	2.96	3.33	3.57	3.66
30/11/2015	465/15	1.79	2.27	2.87	3.25	3.49	3.56
31/12/2015	505/15	1.89	2.42	3.03	3.39	3.62	3.70
31/01/2016	040/15	1.54	2.00	2.65	3.04	3.29	3.38
29/02/2016	082/16	1.42	1.77	2.46	2.95	3.24	3.36
31/03/2016	124/16	1.50	1.85	2.51	2.96	3.22	3.31
	Low	1.36	1.70	2.33	2.78	3.07	3.18
	Average	1.76	2.25	2.88	3.24	3.47	3.55
	High	1.99	2.60	3.28	3.61	3.79	3.87

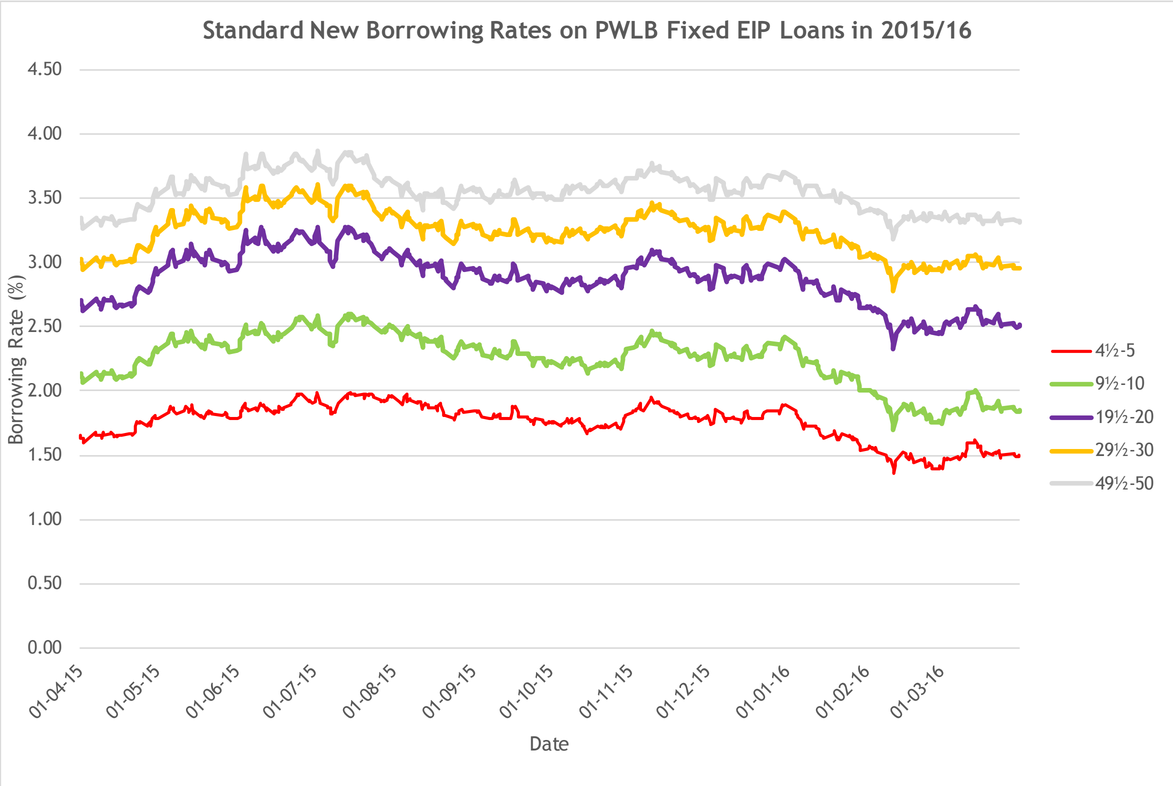

Table 4: PWLB Variable Rates

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR	Pre-CSR	Pre-CSR	Post-CSR	Post-CSR	Post-CSR
01/04/2015	0.62	0.63	0.66	1.52	1.53	1.56
30/04/2015	0.62	0.64	0.67	1.52	1.54	1.57
31/05/2015	0.62	0.65	0.68	1.52	1.55	1.58
30/06/2015	0.62	0.66	0.70	1.52	1.56	1.60
31/07/2015	0.62	0.66	0.72	1.52	1.56	1.62
31/08/2015	0.62	0.66	0.70	1.52	1.56	1.60
30/09/2015	0.66	0.67	0.76	1.56	1.57	1.66
31/10/2015	0.66	0.67	0.76	1.46	1.56	1.57
30/11/2015	0.64	0.67	0.72	1.54	1.57	1.62
31/12/2015	0.63	0.65	0.72	1.53	1.55	1.62
31/01/2016	0.64	0.66	0.69	1.54	1.56	1.59
29/02/2016	0.63	0.65	0.68	1.53	1.55	1.58
31/03/2016	0.61	0.65	0.67	1.51	1.55	1.57
Low	0.61	0.61	0.66	1.51	1.51	1.56
Average	0.63	0.66	0.71	1.53	1.56	1.61
High	0.67	0.69	0.78	1.57	1.59	1.68