Annual Report on the Treasury Management Service and Actual Prudential Indicators for 2016/17

Summary

Report to advise members of the Treasury Management Service performance and to illustrate the compliance with the Prudential Indicators for 2016/17.

Portfolio - Finance
Date signed off: 30 October 2017

Wards Affected	**All**

Recommendation

The Executive is asked to RESOLVE

(i) to note the report on Treasury Management including compliance with the 2016/17 Prudential Indicators;

(ii) that Treasury Consultants be appointed by the Executive Head of Finance in consultation with the Chief Executive to negotiate borrowing opportunities with other providers with the cost being funded from interest savings.

The Executive is asked to RECOMMEND to Full Council to NOTE compliance with the Prudential Indicators for 2016/17.

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. The table below shows investment income from treasury activities (excluding Iceland) from 2011/12 to 2016/17.

1.2

Year	**Investment income from treasury activities**	**Increase/decrease compared to previous year**	
	£'000	£0	%
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%
2016/17	488	-27	-9.90%

1.3 Although treasury income returns decreased slightly in 2016/17 this was against a backdrop of a continuing low interest rate environment nationally coupled with the redemption of investments to repay borrowing. .

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's treasury activity, in common with all other investors, is subject to risks arising from the strength of financial markets and changing interest rates. Although overall responsibility for Treasury Management does rest with the Council, the Council has engaged professional advisors to advise them and therefore to manage and minimise these risks. That said no treasury management activity is without risk and it is the balancing of these risks against returns that forms a key part of the treasury strategy.

2.4 This report is the annual report for the 2016/17 financial year. It includes both a summary of treasury management performance during the year as well demonstrating compliance with the 2016/17 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 second 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 2016/17 Prudential Indicators;

(ii) RESOLVE that Treasury Consultants be appointed by the Executive Head of Finance in consultation with the Chief Executive to negotiate borrowing opportunities with other providers with the cost being funded from interest savings..

(iii) RECOMMEND to Full Council to NOTE compliance with the Prudential Indicators for 2016/17;

5. Supporting Information

Treasury Management Strategy 2016/17

5.1 The Council approved the 2016/17 Treasury Management Strategy, which includes the investment strategy, at its meeting on the 9th February 2016. All treasury management activity complied with the approved treasury management strategy, the CIPFA Code of Practice and the relevant legislative provisions. Further amendments to the strategy to increase the Council's borrowing limit were approved on 24th August 2016 and 9th November 2016.

Investment Strategy 2016/17

5.2 The approved investment strategy for 2016/17 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 2016. A bail-in is rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A bail-in is the opposite of a bail-out, which involves the rescue of a financial institution by external parties, typically governments using taxpayers' money.

Borrowing Strategy 2016/17

5.4 The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2017 was £140.2m (£18.1m at 31 March 2016).

5.5 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. However, new borrowing entered in to this year has been at variable rates and for short term.

Treasury Advisors

5.6 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.

Borrowing and Investment Activity in 2016/17

Borrowing Activity 2016/17

5.7 At 31/03/2017 the Authority's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £140.2m, while usable reserves and working capital which are the underlying resources available for investment were £21.4m on an accruals basis.

5.8 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.

5.9 At 31/03/2017, the Authority had £119m (£17.9m at 31 March 2016) of borrowing and £11.5m (£27.7m at 31 March 2016) of treasury investments. The reason for the sharp change in borrowing and investments over the year was twofold. Firstly the Council borrowed signifincatly to acquire investment property, in particular the Camberley shopping centre, and secondly treasury investments were sold in order to repay borrowing thereby reducing risk. 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 £45m due to future property acquisitions.

5.11 During the year the Council entered in to £101.5m of new short term borrowing. The details are given in the table below:

	31.03.16 Balance £m	**2016/17 Movement £m**	**31.03.17 Balance £m**	**31.03.17 Rate %**
Public Works Loan Board	-16.5	0.1	-16.4	2.9
Local authorities (long term)	-1.5	0.4	-1.1	0.0
Local authorities (short term)	-	-101.5	-101.5	0.3
Total Borrowing	-18.0	-101.0	-119.0	1.1

Investment Activity 2016/17

5.12 The Authority held invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2016/17 the Authority's investment balances have ranged between £10million and £34million. Investment balances decreased to £10million at 31st March 2017 as funds were used to repay short term borrowing. 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 2016/17:

Investment Counterparty	Balance on 1/4/16	Investments Made	Maturities/Investments Sold	Balance on 31/3/17	Average Rate at 31st March
	£000s	£000s	£000s	£000s	%
UK Central Govenrment					
- Short Term	**0**	438	-438	**0**	0.15
- Long Term	**0**	0	0	**0**	-
UK Local Authorities					
- Short Term	**5,500**	2,000	-5,500	**2,000**	0.79
- Long Term	**2,000**	0	0	**2,000**	1.30
Banks, Building Societies & Other Organisations					
- Short Term	**5,259**	74,280	-74,105	**5,434**	0.55
- Long Term	**0**	0	0	**0**	-
AAA-rated Money Market Funds					
- Short Term Cash Equivalents	**6,973**	36,934	-43,906	**0**	0.49
- Long Term	**7,962**	0	-5,908	**2,054**	3.64
Total Investments	**27,693**	**113,652**	**-129,857**	**11,488**	

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 2016/17.

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

5.17 The Council's current accounts, together with a Special Interest Bearing Account are held with NatWest plc who does 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
31/03/2017	4.99	A+	3.06	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 £27m during the year. The Authority's best performing investments in 2016/17 were its £7m of externally managed pooled (bond, equity and property) funds. These generated an average total return of 3.64%, comprising £0.3m income return used to support services in year. Because these funds have no defined maturity date, but are available for withdrawal after notice period, their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed. In light of their strong performance and the Authority's latest cash flow forecasts, investment in the property fund has been maintained for the 2017/18 financial year.

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 disposed of its investments in strategic bond and equity funds but maintained its investment in property funds. The property fund is operated on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; it also offers 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 property fund at short notice, the Authority's intention is to hold them for the medium-term. Its performance and suitability in meeting the Authority's investment objectives are monitored regularly and discussed with Arlingclose.

Update on Investments with Icelandic Banks

5.23 The Council originally had £4m at risk in Iceland due to the collapse of the Icelandic banks in 2008. Over the intervening years this money was repaid in instalments however at the 31st March 2016 a balance of ISK135bn, which represented the remainder of the Council's claim against Glitnir Bank, remained due to Icelandic currency controls. In June 2016 the Icelandic Government announced that they would allow foreign deposits in ISK to be exchanged for one last time in a currency auction. If this opportunity was not taken then the money could remain trapped for several years and indeed be subject to a steep exit payment. On the advice of the Council's professional advisors the decision was taken to take advantage of this offer and the final balance held in Iceland was repaid as Euro712k.

5.24 As a consequence of this there is no more money held in Iceland and the Council has received slightly more than the £4m originally deposited.

Compliance with Prudential indicators

5.25 The Council can confirm that it has complied with its Prudential Indicators for 2016/17, which were approved on 9th February 2016 by Full Council as part of the Council's Treasury Management Strategy Statement. Further amendments to the strategy to increase the Council's borrowing limit were approved on 24th August 2016 and 9th November 2016. Full details are included in Annex C.

5.26 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 2016/17. 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.

Borrowing Strategy for 2017/18

5.27 On the advice of the Council's Treasury advisors the Council has continued to borrow short term from other public bodies rather than longer term from the Public Works Loans Board (PWLB) in order to take advantage of low interest rates. It is our advisors view that rates are unlikely to increase significantly within the next 2 years but that the Council should seek to fix for the longer term so to minimise interest rate risk.

5.28 Although the PWLB offers easy access to funds it does not necessarily offer the lowest rates for longer term borrowing and rates can only be fixed on the day they are borrowed. Arling Close have advised us that potentially the market is able to offer better rates as Councils are viewed favourably and that they are in the market to offer a fixed rate borrowing option for a time in the future. This would mean that the Council would be able to continue to take advantage of low short term rates but be able to minimime the risk of rate rises in the future. Although going to market will have an initial cost this will be more than recovered in interest savings over the life of the loan. It is therefore proposed that consultants be engaged to go to market with the cost of the exercise coming out of interest savings

6. Corporate Objectives And Key Priorities

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

7. Policy Framework

7.1 The 2016/17 Annual Investment Strategy together with the Treasury Management Strategy was approved by Full Council on the 9th February 2016. These set out the parameters under which Treasury Management operates including the Prudential Indicators.

7.2 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.

8. Legal Issues

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

9. Risk Management

9.1 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.

9.2 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.

9.3 The limits applied in respect of counterparties and investments are the <u>overall limits</u> 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.

9.4 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

9.5 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.

Annexes	Annex A – Investments as at 31st March 2017 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
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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 2017

Investments	Notes	Maturity Date	Interest Rate %	Principal
				£
Cash and Cash Equivalents				
NatWest Business Reserve Account	On call		0.01	2,295,134
NatWest Central Account			0.01	1,092,010
Coventry Building Society		28-Apr-17	0.37	2,046,968
Lancashire County Council		28-Apr-17	0.35	2,000,000
Total Cash and Cash Equivalents				**7,434,112**
Long Term Investments				
Loans and Receivables				
Glasgow City Council		30-Oct-18	1.30	2,000,000
Available for Sale				
CCLA Property Fund		Long term	3.40	2,053,609
Total Long Term Investments				**4,053,609**
Total Investments				**11,487,721**

Compliance with Prudential Indicators

The Authority confirms compliance with its Prudential Indicators for 2016/17, which were set in February 2016 then subsequently amended in August 2016 and November 2016.

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:

	2016/17	**2017/18**	**2018/19**
Upper limit on fixed interest rate exposure	£167m	£190m	£190m
Actual	£0.5m		
Upper limit on variable interest rate exposure	£0	£0	£0
Actual	£0.04m		

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%	86%
12 months and within 24 months	100%	0%	0%
24 months and within 5 years	100%	0%	2%
5 years and within 10 years	100%	0%	1%
10 years and within 20 years	100%	0%	2%
20 years and within 30 years	100%	0%	2%
30 years and within 40 years	100%	0%	3%
Over 40 years	100%	0%	4%

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	A+

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	£7m

Annex B

Prudential Indicators 2016/17

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	2016/17 Actual	2016/17 Estimate	2017/18 Estimate
	£m	£m	£m
Capital Program	123.0	122.3	3.9
Total Expenditure	**123.0**	**122.3**	**3.9**
Capital Receipts	0.2	0.5	0.1
Government Grants	0.5	0.6	0.6
Reserves	0.1	0.3	
Revenue	-	0.0	
Borrowing	122.1	120.9	
Total Financing	**0.0**	**-**	**3.2**

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

	31.03.17 Actual £m	**31.03.17 Estimate £m**	**31.03.18 Estimate £m**
Capital Financing Requirement	**140**	**139**	**141**

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	**31.03.17 Actual**	**31.03.17 Estimate**	**31.03.18 Estimate**
	£m	£m	£m
Borrowing	119	121	135
Capital Financing Requirement	140	139	141
Headroom	**21**	**18**	**6**

The figures above could increase significantly if the council 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	**2016/17 £m**	**2017/18 £m**	**2018/19 £m**
Borrowing	157	157	157
Total Debt	**157**	**157**	**157**

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	**2016/17 £m**	**2017/18 £m**	**2018/19 £m**
Borrowing	167	167	167
Total Debt	**167**	**167**	**167**

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	**2016/17 Actual %**	**2016/17 Estimate %**	**2017/18 Estimate %**
General Fund	**0.1**	**-16**	**-39**

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 9th February 2016.

Annex C

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

Economic Review

As we entered 2016, there was a significant uncertainty about the outlook for global growth. The slowdown in the Chinese economy and the knock-on effects for both trading partners and commodity prices, the uncertainty over the outcome of the US presidential election (no clear party or candidate being identified as an outright winner) and the impending referendum on the UK's future relationship with the EU, all resulted in nervousness and a shaky start for markets.

Data released in the April-June quarter showed UK GDP at 2% year/year to March 2016 and annual inflation at 0.3% in May. Core inflation remained subdued as a consequence of weak global price pressures, past movements in sterling and restrained domestic price growth. Internationally, a modest pace of growth in the UK's main trading partners remained the most likely prospect.

Fluctuations in the opinion polls on the EU referendum prompted pronounced volatility in exchange rates, gilts, corporate bonds and equities as the result became increasingly uncertain. Immediately prior to the result, financial market sentiment shifted significantly in favour of a Remain outcome, a shift swiftly reversed as the results came in. The vote to leave the EU sent shockwaves through the domestic, European and global political spectrum, the most immediate impact being the resignation of Prime Minister David Cameron.

Between 23rd June and 1st July the sterling exchange rate index fell by 9% and short-term volatility of sterling against the dollar increased significantly. Worldwide, markets reacted very negatively with a big initial fall in equity prices. Government bond yields also fell sharply by 20-30 bp across all maturities (i.e. prices rose) as investors sought safe haven from riskier assets. The 10-year benchmark gilt yield fell from 1.37% to 0.86%.

Yet, a week on from the result the overall market reaction, although significant, was less severe than some had feared. The 5-year CDS for the UK (the cost of insuring against a sovereign default) rose from 33.5 basis points to 38.4 basis points. The FTSE All Share index, having fallen sharply by 7% from 3,481 points on 23rd June to 3,237 after the result, had subsequently risen to 3,515 by the end of the month.

The Bank of England sought to reassure markets and investors. Governor Mark Carney's speeches on 24th and 30th June in response to the referendum result stressed that the Bank was ready to support money market liquidity and raised the likelihood of a cut in policy rates 'in the summer'. The door was also left open for an increase in the Bank's asset purchase facility (QE). The Governor noted that the Bank would weigh the downside risks to growth against the upside risks to inflation from fall in the value of sterling.

Counterparty Update

Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune although the fall in their share prices was less pronounced.
Fitch downgraded the UK's sovereign rating by one notch to AA from AA+, and Standard & Poor's downgraded its corresponding rating by two notches to AA from AAA. Fitch, S&P and Moody's have a negative outlook on the UK. S&P took similar actions on rail company bonds guaranteed by the UK Government.

Moody's affirmed the ratings of nine UK banks and building societies and revised the outlook to negative for those banks and building societies that it perceived to be exposed to a more challenging operating environment arising from the 'leave' outcome.

There was no immediate change to Arlingclose's credit advice on UK banks and building societies as a result of the referendum result. Our advisor believes there is a risk that the uncertainty over the UK's future trading prospects will bring forward the timing of the next UK recession. In the coming weeks and months Arlingclose will therefore review all UK based institutions, and it is likely that, over time, will advise shortening durations on those institutions considered to be most affected.

Following the UK's vote to leave the European Union, the economic outlook for the UK has immeasurably altered. It will to a large extent be dependent on the nature of the future relationship negotiated with the EU, particularly in relationship to trade. The negotiations crucially hinge on domestic politics which, at the end of the June quarter, were unsettled themselves.

The domestic outlook is uncertain, but likely to be substantially weaker in the short term than previously forecast. Arlingclose has changed its central case for the path of Bank Rate over the next three years. Arlingclose believes any currency-driven inflationary pressure will be looked through by Bank of England policymakers. The likely path for Bank Rate is downwards and the central case is 0.25%, but there is a 40% possibility of that the rate is cut to zero.

In addition, Arlingclose believes that the Government and the Bank of England have both the tools and the willingness to use them to prevent any immediate market-wide problems leading to bank insolvencies. The cautious approach to credit advice means that the banks currently on the Authority's counterparty list have sufficient equity buffers to deal with any localised problems in the short term.

Annex C

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
01/4/2016		0.50		0.36	0.36	0.39	0.46	0.61	0.88	0.78	0.83	0.98
30/4/2016		0.50		0.36	0.36	0.38	0.47	0.62	0.90	0.86	0.95	1.13
31/5/2016		0.50		0.35	0.37	0.39	0.46	0.61	0.89	0.82	0.92	1.09
30/6/2016		0.50		0.35	0.36	0.39	0.43	0.55	0.80	0.49	0.49	0.60
Average		0.50		0.36	0.36	0.38	0.46	0.60	0.86	0.77	0.83	0.98
Maximum		0.50		0.36	0.37	0.39	0.47	0.62	0.90	0.88	0.99	1.20
Minimum		0.50		0.35	0.36	0.37	0.40	0.50	0.73	0.49	0.49	0.58
Spread		--		0.01	0.01	0.02	0.07	0.12	0.17	0.39	0.50	0.62

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

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/4/2016	125/16	1.33	1.82	2.51	3.24	3.33	3.19	3.15
30/4/2016	165/16	1.37	1.95	2.65	3.34	3.40	3.25	3.21
31/5/2016	205/16	1.36	1.93	2.56	3.22	3.27	3.11	3.07
30/6/2016	249/16	1.17	1.48	2.09	2.79	2.82	2.61	2.57
	Low	1.09	1.41	2.05	2.76	2.79	2.59	2.56
	Average	1.31	1.79	2.46	3.17	3.23	3.07	3.03
	High	1.40	2.00	2.71	3.40	3.46	3.31	3.28

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

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/4/2016	125/16	1.50	1.86	2.54	2.99	3.25	3.34
30/4/2016	165/16	1.59	1.99	2.68	3.11	3.34	3.42
31/5/2016	205/16	1.58	1.97	2.58	2.99	3.23	3.30
30/6/2016	249/16	1.24	1.51	2.11	2.55	2.79	2.86
	Low	1.24	1.51	2.11	2.55	2.79	2.86
	Average	1.48	1.83	2.48	2.91	3.15	3.23
	High	1.59	1.99	2.68	3.11	3.34	3.42

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**
1/4/2016	0.61	0.65	0.67	1.51	1.55	1.57
30/4/2016	0.61	0.65	0.67	1.51	1.55	1.57
31/5/2016	0.65	0.66	0.70	1.55	1.56	1.60
30/6/2016	0.64	0.62	0.62	1.54	1.52	1.52
Low	1.51	1.52	1.52	0.61	0.62	0.62
Average	1.53	1.55	1.57	0.63	0.65	0.67
High	1.55	1.56	1.60	0.65	0.66	0.70