Report to	Cabinet	**Item**
	3 February 2016	7
Report of	Chief finance officer	
Subject	Treasury management strategy 2016-17	

Purpose

To outline the council's prudential indicators for 2016-17 through to 2018-19 and set out the expected treasury operations for this period. It fulfils three key reports required by the Local Government Act 2003:

- The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The Minimum Revenue Provision (MRP) Policy, as required by Regulation under the Local Government and Public Involvement in Health Act 2007 (Appendix A); and
- The treasury strategy in accordance with the CIPFA Code of Practice on Treasury Management.

The investment strategy is in accordance with the Department of Communities and Local Government investment guidance

Recommendation

To approve each of the key elements of this report and report these to council.

1. The Capital Prudential Indicators and Limits for 2016-17 through to 2018-19 contained within paragraphs 10 - 15 of this report
2. The Borrowing Strategy 2016-17 through to 2018-19 (paragraphs 21 – 25)
3. The Treasury Prudential Indicators (paragraphs 26 - 29), including the Authorised Limit (paragraph 27)
4. The Minimum Revenue Provision (MRP) policy statement contained in paragraph 16
5. The Investment Strategy 2016-17 (paragraphs 30 – 55) and the detailed criteria included in Appendix 3

Corporate and service priorities

The report helps to meet the corporate priority "value for money services"

Financial implications

The report has no direct financial consequences however it does set the guidelines for how the council manages its borrowing and investment resources

Ward/s: all wards

Cabinet member: Councillor Stonard – resources and income generation

Contact officers

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Background documents

None

Introduction

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

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

3. CIPFA defines treasury management as:

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

4. The council initially adopted the CIPFA Code of Practice on 2 April 2002 and has, through the annual strategy, adopted any subsequent changes or revisions. The adoption of the Code of Practice and the requirement to follow the Code is a requirement under statutory instrument.

The treasury management policy statement

5. The council defines its treasury management activities as:
   The management of the organisation'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.

6. The council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

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

Reporting requirements

8. The cabinet is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. Cabinet is required tio report these to council.

A treasury management strategy statement, including prudential and treasury indicators (this report) **-** The first, and most important report covers:

- capital plans, including prudential indicators;
- the treasury management strategy, including treasury indicators; and
- the Minimum Revenue Provision (MRP) policy, describing how residual capital expenditure is charged to revenue over time;
- the investment strategy.

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An annual treasury management report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

9. The **treasury management strategy statement** 2016-17 covers the following areas:

Capital

- capital plans and prudential indicators
- minimum revenue provision (MRP) strategy

Borrowing

- current treasury management position
- prospects for interest rates
- borrowing strategy, including the policy on borrowing in advance of need and debt rescheduling
- treasury indicators: limits to borrowing activity and affordability, designed to limit the treasury risk to the council

Investments

- annual investment strategy
- creditworthiness policy

Other

- training
- policy on use of external service providers

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

Capital

Capital plans and prudential indicators

10. The council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

11. **Capital expenditure:** This prudential indicator is a summary of the council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

Capital Expenditure	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
£000	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
Non-HRA	7,197	20,778	35,164	18,940	10,062	3,517
HRA	30,515	39,381	47,340	27,693	23,230	23,441
Total Expenditure	**37,712**	**60,159**	**82,504**	**46,633**	**33,292**	**26,958**

The financing need in the table above excludes other long term liabilities such as leasing arrangements which already include borrowing instruments.

Capital expenditure for 2016-17 differs from the proposed capital programme as the figures in the table above include non-housing capital expenditure of £5.195m that is expected to be carried forward at the end of 2015-16 which has already been approved and is therefore not included in the capital programme to be approved.

12. The table below shows how capital expenditure plans are being financed by capital or revenue resources. Any shortfall of resources results in a borrowing need.

Capital Funding	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
£000	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
Financed by:						
Capital receipts	4,342	19,571	11,682	9,323	5,574	5,600
Capital grants	3,777	7,299	8,812	8,173	3,586	3,735
Capital reserves	12,653	12,118	2,423	6,060	10,915	12,780
Revenue	18,049	9,400	26,104	10,788	6,572	4,843
HRA Non- dwelling depreciation	414	751	775	789	807	826
Total Resources	**39,235**	**48,388**	**49,021**	**34,344**	**26,647**	**26,958**
Net financing need for the year	**(1,523)**	**11,771**	**33,483**	**12,289**	**6,645**	**-**

13. **The council's borrowing need (the Capital Financing Requirement):** The second prudential indicator is the council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the council's

underlying borrowing need. Any capital expenditure which has not immediately been paid for will increase the CFR.

14. The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

15. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the council's borrowing requirement, these types of scheme include a borrowing facility and so the council is not required to separately borrow for these schemes. The council currently has £1.19m of such schemes within the CFR.

The council is asked to approve the CFR projections below:

Capital Financing Requirement	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**
£000	**Actual**	**Forecast**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
CFR Non-HRA	27,217	38,746	62,869	72,761	79,139	78,865
CFR HRA	207,286	207,286	216,396	218,535	218,536	218,536
Total CFR	**234,503**	**246,031**	**279,265**	**291,296**	**297,675**	**297,401**
Movement in CFR	(2,600)	11,529	33,233	12,031	6,379	(274)
Movement in CFR is represented by						
Net financing need for the year (above)	(1,523)	11,771	33,483	12,289	6,645	-
Less MRP/VRP and other financing movements	(1,077)	(242)	(250)	(258)	(266)	(274)
Movement in CFR	(2,600)	11,529	33,233	12,031	6,379	(274)

The CFR is increasing due to:

a. presumed borrowing for building properties within the general fund, it makes no assumptions about selling any of the properties built or any usage of the development company for the building of the properties, other than those agreed in the company's business plan;

b. the HRA debt is increasing due the government's policy adjustment on housing rent levels against those in place during the Council's HRA subsidy buy out in 2012. The anticipated lowering of future rent by 1% each year over the next 4 years (2016-17 to 2019-20) has a material adverse impact on the future revenues of the HRA which significantly increases the need for borrowing in order to undertake capital expenditure on existing works and new build.

Part of the CFR movement on 2018-19 relates to the repayment of the LAMS indemnity funding of £1m.

Minimum Revenue Provision (MRP) policy statement

16. The council is required to pay off an element of the accumulated general fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP).

CLG regulations have been issued which require the full council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The council is recommended to approve the following MRP Statement:

- The general repayment policy for prudential borrowing is to repay borrowing within the expected life of the asset being financed, up to a maximum of 50 years. This is in accordance with the 'asset life' method in the guidance. The repayment profile will follow an annuity repayment method, which is one of the options set out in the guidance. This means that MRP will be calculated on an annuity basis (like many domestic mortgages) over the estimated life of the asset.

  This is subject to the following details:

  - An average asset life for each project will normally be used. There will not be separate MRP schedules for the components of a building (e.g. plant, roof etc). Asset life will be determined by the chief finance officer. A standard schedule of asset lives will generally be used, but where borrowing on a project exceeds £10m, advice from appropriate advisers may also be taken into account.
  - MRP will commence in the year following the year in which capital expenditure financed from borrowing is incurred, except for single assets where over £1m financed from borrowing is planned, where MRP will be deferred until the year after the asset becomes operational.
  - Other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent, as justified by the circumstances of the case, at the discretion of the chief finance officer.

- There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

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

For authorities, like Norwich, which participate in LAMS using the cash backed option, the mortgage lenders require a 5 year cash advance from the local authority to match the 5 year life of the indemnity. The cash advance placed with the mortgage lender provides an integral part of the mortgage lending, and should therefore be treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The cash advance is due to be returned in full at maturity, with interest paid annually. Once the cash advance matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (5 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The position should be reviewed on an annual basis.

Borrowing

Current treasury management position

17. The treasury management function ensures that the council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to

meet service activity, including capital expenditure plans. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

18. The council's treasury debt portfolio position at 31 March 2015, with forward projections, is summarised below. The table shows the actual external debt (treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£000	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
External Debt						
Debt at 1 April	223,917	223,917	218,857	253,107	266,107	274,107
Expected change in debt	-	(5,060)	34,250	13,000	8,000	-
Other Long Term Liabilities (OLTL)	1,928	1,847	1,762	1,672	1,576	1,474
Expected change in (OLTL)	(80)	(85)	(90)	(96)	(101)	(107)
Debt at 31 March	**225,764**	**220,619**	**254,779**	**267,683**	**275,581**	**275,474**
Capital Financing Requirement (CFR)	**234,503**	**246,031**	**279,265**	**291,296**	**297,675**	**297,401**
Under/(over) borrowing	**8,739**	**25,413**	**24,486**	**23,613**	**22,094**	**21,927**

The debt is increasing due to:

a. presumed borrowing for building properties within the general fund, it makes no assumptions about selling any of the properties built or any usage of the development company for the building of the properties, other than those agreed in the company's business plan;

b. the HRA debt is increasing due the government's policy adjustment on housing rent levels against those in place during the council's HRA subsidy buy out in 2012. The lowering of future rent by 1% each year over the next 4 years (2016-17 to 2019-20) has a material adverse impact on the future revenues of the HRA which significantly increases the need for borrowing in order to undertake capital expenditure on existing works and new build.

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

The chief finance officer reports that the council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Prospects for interest rates

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

Annual Average %	Bank	PWLB Borrowing Rates		
		5 yr	25 yr	50 yr
Dec-15	0.50%	2.30%	3.60%	3.50%
Mar-16	0.50%	2.40%	3.70%	3.60%
Jun-16	0.75%	2.60%	3.80%	3.70%
Sep-16	0.75%	2.70%	3.90%	3.80%
Dec-16	1.00%	2.80%	4.00%	3.90%
Mar-17	1.00%	2.80%	4.10%	4.00%
Jun-17	1.25%	2.90%	4.10%	4.00%
Sep-17	1.50%	3.00%	4.20%	4.10%
Dec-17	1.50%	3.20%	4.30%	4.10%
Mar-18	1.75%	3.30%	4.30%	4.20%
Jun-18	1.75%	3.40%	4.40%	4.20%
Sep-18	2.00%	3.50%	4.40%	4.30%
Dec-18	2.00%	3.50%	4.40%	4.30%
Mar-19	2.00%	3.60%	4.50%	4.40%

Further detailed interest rate forecasts are given in Appendix 1.

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

The Inflation Report was also notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 - early 2016 but a second, more recent round of falls in fuel prices will now delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% in the second half of 2016 and not get to near 2%

until 2017, though the forecasts in the Report itself were for an even slower rate of increase. There is considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the Monetary Policy Committee will decide to make a start on increasing Bank Rate.

USA. The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.1% in quarter 3. The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 has prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own Monetary Policy Committee.

EZ. In the Eurozone, the European Central Bank in January 2015 unleashed a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to an improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y-y) but came in at +0.4% (+1.5% y-y) in quarter 2 and +0.3% in quarter 3. However, this lacklustre progress in 2015 together with the recent downbeat Chinese and emerging markets news, has prompted comments by the ECB that it stands ready to strengthen this programme of QE by extending its time frame and - or increasing its size in order to get inflation up from the current level of around zero towards its target of 2% and to help boost the rate of growth in the EZ.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

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

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

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

- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

Borrowing strategy

21. The council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the CFR) has not been fully funded with loan debt as cash supporting the council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

22. Against this background and the risks within the economic forecast, caution will be adopted with the 2016-17 treasury operations. The chief finance officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

Any decisions will be reported to Cabinet at the next available opportunity.

23. **Policy on borrowing in advance of need:** The council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the council can ensure the security of such funds.

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

24. **Debt rescheduling:** As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place may include:

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

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the council, at the earliest meeting following its action.

25. **UK Municipal Bonds Agency**
The UK Municipal Bonds Agency, set up in 2015, is now offering loans to local authorities. It is hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

Treasury indicators: limits on borrowing activity and affordability

26. **The operational boundary:** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational Boundary £000	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	**Forecast**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Borrowing	223,917	218,857	253,107	266,107	274,107	274,107
Other long term liabilities	1,847	1,762	1,672	1,576	1,474	1,367
Total	**225,764**	**220,619**	**254,779**	**267,683**	**275,581**	**275,474**

The operational boundary is increasing due to:

a. presumed borrowing for building properties within the general fund, it makes no assumptions about selling any of the properties built or any usage of the development company for the building of the properties, other than those agreed in the company's business plan;

b. the HRA debt is increasing due the government's policy adjustment on housing rent levels against those in place during the Council's HRA subsidy buy out in 2012. The lowering of future rent by 1% each year over the next 4 years (2016-17 to 2019-20) has a material adverse impact on the future revenues of the HRA which significantly increases the need for borrowing in order to undertake capital expenditure on existing works and new build.

27. **The authorised limit for external debt:** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full council. It reflects the

level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

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

Authorised Limit £000	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
Borrowing	263,917	258,857	293,107	306,107	314,107	314,107
Other long term liabilities	1,847	1,762	1,672	1,576	1,474	1,367
Total	**265,764**	**260,619**	**294,779**	**307,683**	**315,581**	**315,474**

The authorised limit is increasing due to:

a. presumed borrowing for building properties within the general fund, it makes no assumptions about selling any of the properties built or any usage of the development company for the building of the properties, other than those agreed in the company's business plan;
b. the HRA debt is increasing due the government's policy adjustment on housing rent levels against those in place during the Council's HRA subsidy buy out in 2012. The lowering of future rent by 1% each year over the next 4 years (2016-17 to 2019-20) has a material adverse impact on the future revenues of the HRA which significantly increases the need for borrowing in order to undertake capital expenditure on existing works and new build.

There are other implications of the Housing and Planning Bill 2015-16 are outlined in paragraphs 6.15 to 6.21 of the Housing Rents and Budgets 2016-17 report.

Separately, the council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA debt limit	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
£000	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
HRA Debt Cap	236,989	236,989	236,989	236,989	236,989	236,989
HRA CFR	207,286	207,286	216,396	218,535	218,536	218,536
HRA Headroom	29,703	29,703	20,593	18,454	18,453	18,453

Slippage from 2015-16 to 2016-17 of the capital programme has been reflected in the CFR for 2016-17 which has reduced the headroom.

Treasury management limits on activity

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

- **Upper limits on variable interest rate exposure:** This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- **Upper limits on fixed interest rate exposure:** This is similar to the previous indicator and covers a maximum limit on fixed interest rates
- **Maturity structure of borrowing:** These gross limits are set to reduce the council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits

The council is asked to approve the following treasury indicators and limits:

£m	2014-15	2015-16	2016-17
Interest rate exposures			
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	20%	20%	20%
Limits on fixed interest rates: • *Debt only* • *Investments only*	 100% 100%	 100% 100%	 100% 100%
Limits on variable interest rates • Debt only • Investments only	 20% 20%	 20% 20%	 20% 20%
Maturity structure of fixed interest rate borrowing			
		Lower	**Upper**
Under 12 months		0%	10%
12 months to 2 years		0%	10%
2 years to 5 years		0%	30%
5 years to 10 years		0%	50%
10 years and above		0%	95%

29. **Affordability prudential indicators**: The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are also required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the council's overall finances. The council is asked to approve the following indicators:

- **Ratio of financing costs to net revenue stream:** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
Non-HRA	4.79%	5.10%	7.67%	10.82%	14.81%	17.44%
HRA	11.96%	11.85%	10.65%	10.64%	10.19%	9.84%

The estimates of financing costs include current commitments and the proposals in this budget report, which are increasing due increased borrowing to fund building of properties. As stated above The debt is increasing due to presumed borrowing for building properties within the HRA and GF, it makes no assumptions about selling any of the properties built or of any special purpose vehicle usage for the building of the properties. Projects will not go ahead unless there is an expectation that revenue streams generated will fully fund the associated borrowing costs and provide n additional return.

- **Incremental impact of capital investment decisions on council tax:** This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the 2016-17 budget report compared to the council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of government support, which are not published over a three year period.
- **Incremental impact of capital investment decisions on the band D council tax:** The impact of capital expenditure on the council tax would be derived from the effect of Revenue Contributions to Capital on the Council Tax Requirement. Since the council does not budget for any significant revenue contributions, the impact on the Council Tax Requirement, and therefore council tax, is nil.

- **Estimates of the incremental impact of capital investment decisions on housing rent levels:** Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in the 2016-17 budget report compared to the council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

  A key change to the HRA's capital investment programme has been the government's policy adjustment on housing rent levels against those in place during the Council's HRA subsidy buy out in 2012. The anticipated lowering of future rent by 1% each year over the next 4 years (2016-17 to 2019-20) has a material adverse impact on the future revenues of the HRA which significantly reduces the ability of the HRA to undertake capital expenditure on existing works and new build. This will reduce the HRA's overall activity in the future and will reduce future revenue levels through new build and other revenue initiatives.

Investments

Annual investment strategy

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

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

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of ….. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

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

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31. **Core funds and expected investment balances:** The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
£000	**Actual**	**Forecast**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Fund balances	29,794	25,935	10,876	11,022	9,578	8,580
Capital receipts	24,895	-	-	-	-	-
Earmarked reserves	4,084	-	-	-	-	-
S106, CIL & grants	5,078	4,643	3,691	1,620	-	-
Total Core Funds	**63,852**	**30,579**	**14,567**	**12,643**	**9,578**	**8,580**
Working Capital*	48,722	25,500	25,500	25,500	25,500	25,500
Expected Investments	**67,541**	**33,536**	**37,624**	**40,401**	**40,998**	**43,514**

*Working capital balances shown are estimated year end; these may be higher mid year

A proportion of the capital receipts are ringfenced so can only be spent on specific capital works. It has been assumed that any capital receipts arising in a year are used to finance the capital programme in that year.

32. **Investment policy:** The council's investment policy has regard to the CLG's Guidance on Local government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Capita Asset Services (formerly Sector)al Guidance Notes ("the CIPFA TM Code"). The council's investment priorities will be security first, liquidity second, then return.

33. In accordance with the above guidance from the Welsh government and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

34. Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

35. Further, the council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

36. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

37. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

38. The intention of the strategy is to provide security of investment and minimisation of risk.

39. Investment instruments identified for use in the financial year are listed in Appendix 3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the council's treasury management practices – schedules.

40. **Creditworthiness policy:** The primary principle governing the council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the council will ensure that:

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

41. The chief finance officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the council may use, rather than defining what types of investment instruments are to be used.

42. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the council's criteria, the other does not, the institution will fall outside the lending criteria. Credit rating information is supplied by Capita Asset Services, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum council criteria will be suspended from use, with all others being reviewed in light of market conditions.

43. The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) are:

- Banks 1 - good credit quality **–** the council will only use banks which:
  - are UK banks; and-or
  - are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA
  - and have, as a minimum, the following Fitch, Moody's and Standard Poors credit ratings (where rated):
- Short term - F1, P1, A1
- Long term – A, A2, A
- Viability - financial strength – bbb+ (Fitch - Moody's only)
- Support – 5(Fitch only)
- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation - The council will use these only where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies The council will *use* all societies which:
  - meet the ratings for banks outlined above
  - have assets in excess of £2bn

    - or meet both criteria.
- Money market funds – *AAA*
- UK government (including gilts and the DMADF)
- Local authorities, parish councils etc
- Supranational institutions

44. **Country and Capita Asset Services considerations:** Due care will be taken to consider the country, group and sector exposure of the council's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition:
    - no more than 30% will be placed with any non-UK country at any time
    - limits in place above will apply to a group of companies
    - sector limits will be monitored regularly for appropriateness

45. **Use of additional information other than credit ratings:** Additional requirements under the Code require the council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches-outlooks) will be applied to compare the relative security of differing investment counterparties.

46. **Time and monetary limits applying to investments:** The time and monetary limits for institutions on the council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch long term rating (or equivalent)	**Money Limit**	**Time Limit**
Banks 1 category high quality	AA	£15m	364 days
Banks 1 category lower quality	AA	£10m	364 days
Banks 2 category part nationalised	N/A	£15m	3 yrs
Limit 3 category - council's own banker (not meeting banks 1)	A-	£5m	3 months
Building Societies	Asset worth £2bn	£10m	364 days
DMADF	AAA	unlimited	6 months
Local Authorities	N/A	£10m per LA	5 years
Money market funds	AAA	£5m per fund £25m overall limit	liquid

47. **Country limits:** The council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

48. **In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

49. **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2016-17 1.00%
- 2017-18 1.75%
- 2018-19 2.00%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth weakens for longer than expected. However, should the pace of growth quicken, there could be upside risk.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

- 2016-17 0.90%
- 2017-18 1.50%
- 2018-19 2.00%
- 2019-20 2.25%
- 2020-21 2.50%
- 2021-22 3.00%
- 2022-23 3.00%

Later years 3.00%

50. **Investment treasury indicator and limit:** Total principal funds invested for greater than 364 days. These limits are set with regard to the council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The cabinet is asked to approve the treasury indicator and limit:

Maximum Principle Funds invested >364 days			
£m	**2016/17**	**2017/18**	**2018/19**
Principle funds invested > 364 days	£15m	£15m	£15m

For its cash flow generated balances, the council will seek to utilise its business reserve instant access and notice accounts and short-dated deposits (overnight to three months), in order to benefit from the compounding of interest.

51. **Investment risk benchmarking:** These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

52. **Security** - The council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio

- in addition, that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	0.05%	0.04%	0.03%	0.02%	0.01%

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

53. **Liquidity** – in respect of this area the council seeks to maintain:
    - Bank overdraft – zero balance
    - Liquid short term deposits of at least £1m available with a week's notice
    - Weighted average life benchmark is expected to be 0.45 years, with a maximum of 2.77 years

54. **Yield -** local measures of yield benchmarks are
    - Investments – internal returns above the 7 day LIBID rate

55. At the end of the financial year, the council will report on its investment activity as part of its annual treasury management report.

Other

Training

56. The CIPFA code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. Members received treasury management training from Capita's Richard Dunlop in November 2013 and further training will be arranged as required.

57. The training needs of treasury management officers are periodically reviewed.

Treasury Management Consultants

58. The council uses Capita Asset Services as its external treasury management advisors.

59. The council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

60. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Integrated impact assessment	NORWICH City Council

The IIA should assess **the impact of the recommendation** being made by the report
Detailed guidance to help with completing the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	Cabinet
Committee date:	03 February 2016
Head of service:	Justine Hartley
Report subject:	Treasury Management Strategy 2016-17
Date assessed:	22-01-2016
Description:	This report outlines the council's prudential indicators for 2016-17 through to 2018-19 and sets out the expected treasury operations for this period.

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	X	☐	The report has no direct financial consequences however it does set the guidelines for how the council manages its borrowing and investment resources
Other departments and services e.g. office facilities, customer contact	☐	☐	☐	
ICT services	☐	☐	☐	
Economic development	☐	☐	☐	
Financial inclusion	☐	☐	☐	
Social (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☐	☐	☐	
S17 crime and disorder act 1998	☐	☐	☐	
Human Rights Act 1998	☐	☐	☐	
Health and well being	☐	☐	☐	

	Impact			
Equality and diversity (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☐	☐	☐	
Eliminating discrimination & harassment	☐	☐	☐	
Advancing equality of opportunity	☐	☐	☐	
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☐	☐	☐	
Natural and built environment	☐	☐	☐	
Waste minimisation & resource use	☐	☐	☐	
Pollution	☐	☐	☐	
Sustainable procurement	☐	☐	☐	
Energy and climate change	☐	☐	☐	
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☐	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues

Interest Rate Forecasts 2016-2019

APPENDIX 1

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

Capita Asset Services Interest Rate View														
	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank Rate View	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
3 Month LIBID	0.60%	0.70%	0.80%	0.90%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	1.90%	2.00%	2.00%	2.10%
6 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.10%	2.20%	2.20%	2.30%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.40%	2.50%	2.50%	2.70%
5yr PWLB Rate	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
10yr PWLB Rate	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
25yr PWLB Rate	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
50yr PWLB Rate	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%
Bank Rate														
Capita Asset Services	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	-	-	-	-	-
5yr PWLB Rate														
Capita Asset Services	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
Capital Economics	2.40%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-
10yr PWLB Rate														
Capita Asset Services	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
Capital Economics	3.35%	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
25yr PWLB Rate														
Capita Asset Services	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
Capital Economics	3.35%	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
50yr PWLB Rate														
Capita Asset Services	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%
Capital Economics	3.40%	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

Economic Background

UK. UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y-y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.2%.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. However, it is unlikely that the MPC would start raising rates until wage inflation was expected to consistently stay over 3%, as a labour productivity growth rate of around 2% would mean that net labour unit costs would still only be rising by about 1% y-y. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. However, the first round of falls in oil, gas and food prices in late 2014 and in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 - early 2016 but only to be followed by a second, more recent, round of falls in fuel prices which will now delay a significant tick up in inflation from around zero. CPI inflation is now expected to get back to around 1% in the second half of 2016 and not get near to 2% until 2017, though the forecasts in the Report itself were for an even slower rate of increase.

There is, therefore, considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, accordingly, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 2016. Increases after that are also likely to be at a much slower pace, and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008.

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

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

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. would start to increase rates in September. The Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong while November was also reasonably strong; this, therefore, opened up the way for the Fed. to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

EZ. In the Eurozone, the EBC, in January 2015 unleashed a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to an improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y-y) but came in at +0.4% (+1.5% y-y) in quarter 2 and +0.3% in quarter 3. However, this more recent lacklustre progress, combined with the recent downbeat Chinese and emerging markets news, has prompted comments by the ECB that it stands ready to strengthen this programme of QE by extending its time frame and - or increasing its size in order to get inflation up from the current level of around zero towards its target of 2%. The ECB will also aim to help boost the rate of growth in the EZ.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the initial resistance of the Syriza government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

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

China and Japan. Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Abe government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its ‘arrows’ of reform but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the government has been very active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market during the summer. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of the bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, concerns about whether the Chinese economy could be heading for a hard landing, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, remain a concern.

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

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

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

CAPITA ASSET SERVICES FORWARD VIEW

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

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

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in November, (based on short sterling), for the first Bank Rate increase are currently around mid-year 2016.

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

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

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

- Uncertainty around the risk of a UK exit from the EU.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The CLG issued Investment Guidance in 2010, and this forms the structure of the council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime*.*

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Capita Asset Services (formerly Sector)al Guidance Notes. This council adopted the Code on 22 March 2011 and will apply its principles to all investment activity. In accordance with the Code, the chief finance officer has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year*,* covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the council will use. These are high security (i.e. high credit rating, although this is defined by the council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the council is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this

covers pooled investment vehicles, such as money market funds, rated *AAA* by Standard and Poor's, Moody's or Fitch rating agencies*.*

5. A body that is considered of a high credit quality (such as a bank or building society For category 5 this covers bodies with a minimum short term rating of A- (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is:

Non-specified investments –are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments

	Non Specified Investment Category	Limit (£ or %)
a.	**Supranational bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds -** These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom government** (e.g. The Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	 £15m £15m
b.	**Gilt edged securities** with a maturity of greater than one year. These are government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£15m
c.	The council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	£5m
d.	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The council may use such building societies which have a minimum asset size of £2bn but will restrict	£10m or 1% of assets

	these type of investments to	
e.	Any **bank or building society** that has a minimum long term credit rating of A+-A,, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	Maximum Limit of 100%, so long as no more than 25% of investments have maturities of longer the one year at any one time.
f.	Any **non rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to having a minimum asset size of £250m and a restriction on the investment amount to 1% of its assets size.	£10m for a maximum of 3 months
g.	**Certifcates of Deposit** or corporate bonds with banks and building societies	£5m
h.	Money market funds	£5m
i.	**Pooled property funds** – The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. The key exception to this is an investment in the CCLA Local Authorities Property Fund.	CCLA £5m

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The council receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services (formerly Sector) as and when ratings change, and counterparties are checked promptly On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the chief finance officer, and if required new counterparties which meet the criteria will be added to the list.

The treasury management role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy-practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.