East Devon District Council Treasury Management Strategy 2016/17

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

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1. **Introduction**

1.1 Background

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.

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's risk or cost objectives.

The Council operates its treasury management function with reference to the Chartered Institute of Public Finance & Accounting Guidance laid out in the Code of Practice for Treasury Management in Public Services (CIPFA Code) and the Department for Communities & Local Government (CLG) Guidance on Local Government Investments.

CIPFA defines treasury management as:

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

The Council adopts the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. All treasury management matters are undertaken in accordance with the code, which recommends best practice in treasury management, including setting a strategy and reporting requirements.

1.2 Reporting Requirements

Under the CIPFA Code and CLG Guidance the Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and Treasury Indicators and Treasury Strategy

This, the first, and most important report covers:

- the capital plans (including prudential indicators);

- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report

This will update members with the progress of the capital position, amending prudential indicators as necessary, and noting whether any policies require revision.

An annual treasury report

This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

In addition to the above reports, Cabinet will be provided with an overview of treasury return against budget and prediction of likely outturn and year end variance as part of the financial monitoring reports presented to Members throughout the year.

Cabinet is required to scrutinise the above reports before they are recommended to Council.

1.3 Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

Capital issues

- the capital plans and the prudential indicators; and,
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and,
- policy on use of external 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.

1.4 Training and Review

CIPFA's revised code requires the Strategic Lead Finance (Section 151 Officer) to ensure that all Members tasked with treasury management responsibilities, particularly those responsible for scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. During October 2015 Capita Asset Services provided a training session tailored towards Members in relation to treasury management, and a follow up session is due to be provided later this year.

The training needs of treasury management officers are periodically reviewed. There is a post with specific responsibility for treasury management within the accountancy team and the Council is committed to ensuring the holder has the relevant qualifications and has access to the training and support required to undertake this role.

In addition, the Council's treasury management team is a member of the South West Treasury Management Benchmarking Group hosted by Capita Asset Services. This group has members from approximately 14 authorities and provides a forum for interpreting Treasury Management data across the area and sharing best practice. The group also allows the opportunity to consider any potential forthcoming treasury management risks, the early identification of which can aid proactive investment management.

The Council maintains an internal audit function through the South West Audit Partnership (SWAP). SWAP undertakes a periodic internal audit review of the treasury management function. In the latest audit by SWAP, which covered the 2015/16 financial year, the treasury management function was given a Substantial Opinion, which is the highest level of assurance available.

Further review is also provided by the external audit team, currently KPMG, who consider the reporting of treasury management data within the financial statements as part of their external audit opinion work.

1.5 Treasury Management Consultants

The Council uses Capita Asset Services, Treasury Solutions as its external treasury management advisors.

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 its external service providers.

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, documented, and subjected to regular review.

2 The Capital and Prudential Indicators 2014/15 – 2018/19

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist Members' overview and confirmation of the capital expenditure plans.

These indicators help show the effect of the financing and borrowing strategy that the Council plans to adopt over the next three financial years.

The Prudential Code and the indicators set, support the system of capital investment in the authority. They are set with regard to:

- Service objectives – strategic planning for the authority
- Stewardship of assets – asset management planning
- Value for money – option appraisal
- Prudence and sustainability – external borrowing implications
- Affordability – implications for council tax and housing rents
- Practicality – achievability of the forward plan

The indicators also act as an early warning system, to flag up if the Council decides to set capital programmes without the necessary finances to fund them.

2.1 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. Members are asked to approve the capital expenditure forecasts:

Table 1 shows both actual capital expenditure incurred in 2014/15 and estimates for the years 2015/16 to 2018/19.

Table 1. Total Capital Expenditure to be incurred (Actual and Estimated)

	Actual	Per 16/17 Estimates			
	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£000	**£000**	**£000**	**£000**	**£000**
General Fund	13,046	6,594	*18,766	4,230	690
HRA	891	1,504	625	625	625
Sub Total	**13,937**	**8,098**	**19,391**	**4,855**	**1,315**
Major Repairs	4,849	4,946	5,150	5,150	5,150
Total	**18,786**	**13,044**	**24,541**	**10,005**	**6,465**

*This includes the estimated £6m loan for the refuse contract fleet, see 3.1 for further detail.

These figures show the Council's capital programme net of any grants or contributions received from third parties. The total capital expenditure also includes that related to major repairs, which for accounting purposes is shown within the HRA. The above financing need excludes other long term liabilities, such leasing arrangements which already include borrowing instruments.

The Council's Capital Programme is funded from various sources:

- Use of capital receipts (sale proceeds from assets)
- Contributions from revenue budgets
- Capital grants e.g. Environment Agency Grants, Disabled Facility Grant
- Contributions from other parties e.g. Devon County Council

Table 2 below summarises the above capital expenditure plans per the budget and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Table 2. Financing of Capital Expenditure

	Actual	**Per 2016/17 Estimates**			
Capital expenditure	**2014/15 £000**	**2015/16 £000**	**2016/17 £000**	**2017/18 £000**	**2018/19 £000**
Non-HRA	13,046	6,594	18,766	4,230	690
HRA	5,740	6,450	5,775	5,775	5,775
Total	**18,786**	**13,044**	**24,541**	**10,005**	**6,465**
Financed by:					
Capital receipts	(1,147)	(1,953)	(2,545)	(8,352)	(443)
Grants	(8,940)	(1,465)	(2,403)	(3,346)	(3,878)
Reserves	(2,259)	(3,535)	(1,103)	1,052	3,185
Revenue contributions to capital funding	(5,192)	(4,996)	(5,477)	(5,475)	(5,475)
Repayment of loans linked to a specific capital receipt	0	755	443	8,882	146
Net financing need for the year	**1,248**	**1,850**	**13,456**	**2,766**	**0**

Any planned expenditure in excess of the above funding streams is known as an unfunded balance which can be met from reserves or borrowing. The Capital Reserve at the 2014/15 year end stood at £2.038m.

2.2 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 above, which has not immediately been paid for, will increase the CFR.

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.

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility within the lease payment and so the Council is not required to separately borrow for these schemes. As at the end of 2015/16 the Council will have no such schemes within the CFR.

In summary the CFR represents the Council's underlying need to borrow for capital purposes less any principal already repaid.

Table 3 shows both the actual CFR for 2014/15 and the estimates for 2015/16 to 2018/19. The Council is asked to approve these projections.

Table 3. Capital Financing Requirement (CFR)					
	Actual	**Per 16/17 Estimates**			
	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£000	**£000**	**£000**	**£000**	**£000**
General Fund	1,445	2,437	14,467	8,230	7,480
Housing Revenue Account	84,426	83,398	82,608	81,298	79,710
Totals	**85,871**	**85,835**	**97,075**	**89,528**	**87,190**
Movement in CFR	**118**	**(36)**	**11,240**	**(7,547)**	**(2,338)**
Movement in CFR Represented by					
Net Financing need for the year	1,248	1,850	13,456**	2,766	0
Less MRP* and other financing movements	(1,130)	(1,886)	*** (2,216)	**** (10,313)	(2,338)
	118	**(36)**	**11,240**	**(7,547)**	**(2,338)**

* MRP – Minimum Revenue Provision

** This includes the estimated £6m loan for the refuse contract, and the loan drawdown for the short-term element of the office relocation.

*** This includes the £0.7m rescheduling of the HRA loan repayments

**** This includes the repayment of the short-term element of the office relocation.

These figures include an expectation to use internal borrowing of £1.2m between 2014/15 and 2018/19.

2.3 Current Portfolio Position of Gross Debt

Table 4 shows the Council's gross debt for 2014/15 and the estimated debt balance at each year end from 2015/16 to 2018/19. This includes the potential short-term cash flow borrowing.

Table 4. Total Borrowing Outstanding					
	Actual	**Per 16/17 Estimates**			
	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£000	**£000**	**£000**	**£000**	**£000**
Borrowing					
General Fund	1,445	4,787	16,827	10,590	9,850
Housing Revenue Account	84,426	83,398	82,608	81,298	79,710
Total Borrowing	**85,871**	**88,185**	**99,435**	**91,888**	**89,560**

2.4 Gross Debt v Capital Financing Requirement (CFR)

A comparison of the Council's Gross Debt to CFR is required by the Prudential Code, with explanations of any variances, to ensure that over the medium term the council only borrows to fund its capital programme. This is shown in Table 5.

Table 5. Gross Debt v Capital Financing Requirement					
	Actual	**Per 16/17 Estimates**			
	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£000	**£000**	**£000**	**£000**	**£000**
Gross Debt	85,871	88,185	99,435	91,888	89,560
Total CFR	85,871	85,835	97,075	89,528	87,190
Sub total	**0**	**2,350**	**2,360**	**2,360**	**2,370**
Cash Flow Borrowing	0	2,350	2,360	2,360	2,370
Variance	**0**	**0**	**0**	**0**	**0**

The cash flow borrowing above represents the maximum bank overdraft plus an estimate of potential short term funding to cover year end requirements. The strategy is managed to avoid such short term, and it is unlikely that this borrowing will need to be called upon but it has been included here to reflect a potential 'worse case' scenario. This table clearly demonstrates that the borrowing undertaken is only to fund the Council's capital programme.

2.5 Minimum Revenue Provision (MRP) Policy Statement

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*:*

For all unsupported borrowing (including finance leases) the MRP policy will be:

- Asset life (Annuity) Method; – MRP is the principal element for the year of the annuity, required to repay over the asset life, the amount of capital expenditure financed by borrowing (option 3).

This option provides for a reduction in the borrowing need over approximately the asset's life. The use of this option by EDDC is consistent with the prior year, and is recognised by CIPFA as being the most popular option in practice.

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. In practice a loan repayment scheme has been defined based on the business plan, with a balance being struck between repaying as soon as possible and allowing the HRA to generate sufficient surpluses as a cushion against uncertainties and to carry out improvements to stock.

Repayments included for finance leases are applied as MRP.

2.6 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:

2.6.1 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.

Table 6 shows how this indicator is calculated. A positive figure indicates external debt.

Table 6. Basis of Calculation for Ratio of Financing Costs to Net Revenue Stream				
General Fund (GF):				
Financing costs Minimum Revenue Provision (see 9.0) Plus Interest charged on loans and Finance Leases Less Interest earned on investments	÷	**Budget requirement** Revenue Support Grant + Council Tax	=	**The ratio of financing costs to net revenue stream (General Fund)** as a %
Housing Revenue Account (HRA):				
Financing costs Voluntary Revenue Provision (see 9.0) Plus Interest charged on loans and Finance Leases Less Interest earned on investments	÷	**Budget requirement** Council house tenants income +/- Contribution to or from HRA reserves	=	**The ratio of financing costs to net revenue stream (HRA)** as a %

Table 7 shows both the actual ratio of financing costs to net revenue stream for 2014/15 and the estimates for 2015/16 to 2018/19.

Table 7. Ratio of Financing Costs to Net Revenue Stream					
	Actual	**Per 16/17 Estimates**			
	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	%	**%**	**%**	**%**	**%**
General Fund	(0.65)	(0.74)	0.37	3.77	2.67
HRA	16.32	20.19	23.18	22.33	24.80

The estimates of financing costs include current commitments, the proposals in the budget report, and the funding of the fleet required to deliver the new refuse contract.

The General Fund ratio reflects the estimation that a higher level of investment income is received compared to that paid out in borrowing until 2016/17. From 2016/17 the financing costs start to increase as loan finance is used to support the refuse contract in terms of fleet purchase, and the longer term element of the office relocation project. This is countered to some extent by the prediction that interest rate returns will also increase over the period. These ratios do not include the impact of the principal associated with the short term cash flow financing for Queen's Drive and the office relocation, nor do they include the impact of financing 'political' investments such as associated with Beer CLT, as the latter are cost neutral to the Council and therefore do not impact tax payers.

The HRA ratio changes are as a result of the principal associated with the HRA self financing loans becoming due.

2.6.2 Incremental Impact of Capital Investment Decisions on Council Tax and Average Weekly Housing Rents

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this 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.

Table 8 shows the incremental impact of capital investment decisions proposed in the budget report. Only the financing costs associated with the General Fund capital loans are included within the calculation of impact on annual council tax, and only the financing costs associated with HRA capital loans are included within the calculation of the impact on average weekly housing rent. These figures have been adjusted in the same way as those in Table 7, as explained above.

Table 8. Incremental Impact of New Capital Investment Decisions on Council Tax and Weekly Housing Rents					
	Actual	**Per 16/17 Estimates**			
	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£	**£**	**£**	**£**	**£**
Band D Annual Council Tax	1.33	2.10	8.43	16.01	14.51
Average Weekly Housing Rent	14.24	16.32	18.44	17.72	18.98

The indicator takes into account the Council Tax base of 56,404 (2015: 55,289) and housing stock of 4,211 (2015: 4,228) for 2016/17.

The increase from 2016/17 onwards reflects the potential increase in capital financing due to the purchase of the refuse fleet.

3 Borrowing

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 this service activity. This includes both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury and prudential indicators, the current and projected debt positions and the annual investment strategy.

Currently all project borrowing is undertaken via the Public Works Loan Board PWLB), however officers review alternative sources of borrowing and select those offering the lowest cost to the Council at the time the funding is required.

3.1 General Fund

The Council's General Fund (GF) currently has one annuity loan associated with the delivery of services. This is in relation to recycling and refuse and it will have a remaining capital balance of £0.326m as at the end of 2015/16. The annual debt repayment for this loan is £0.072m (including interest of £0.014m for 2015/16). This loan is at a fixed rate of interest and includes an annual repayment of both principal and interest, which due to its nature vary each year depending on the loan balance.

During 2015/16 the Council borrowed £1.45m from PWLB to finance a loan issued to Leisure East Devon (LED) to fund the leisure centre enhancement programme. A further facility of £0.4m is available to be drawn down by LED, and it has been assumed that this will be done before the end of 2015/16 for the purposes of this report. When this amount is called upon EDDC will take out a loan from PWLB to cover the cash flow. In effect this loan should not cost EDDC anything as LED is responsible for covering the principal and interest repayments.

The GF also has one maturity loan with a remaining capital balance totalling £0.305m as at the end of 2015/16. The Council has loaned the same amount onto Beer Community Land Trust Limited at the same rates as those charged to EDDC by PWLB. For 2015/16 the annual interest payable on this loan is £0.005m. In effect this loan has a nil cost in cash terms to EDDC. This loan was provided to facilitate the building of affordable housing in Beer for the local community.

The 2016/17 capital estimates indicate that between 2016 and 2017 a total of £7.99m will be required in the short term to fund the office relocation in advance of capital receipts. A further £1.2m has been identified as a longer term requirement in relation to this project. The latter has been included in this strategy as an annuity loan over 20 years required from 2017/18, which based on current rates, would result in an £0.083m combined charge for capital and interest per annum.

The 2016/17 capital estimates also require £0.75m to fund the Queen's Drive project in advance of capital receipts between 2016 and 2017. Based on current rates the estimated impact of borrowing this amount for one year is an interest charge of £0.011m.

In addition to those items already within the capital estimates, this strategy also includes an estimated level of borrowing to fund the capital costs associated with the fleet required to deliver the new refuse contract. At the time of writing, the actual costs of the fleet are unknown (separate paper to Cabinet), so a borrowing requirement of £6m has been included within the strategy. This is a prudent estimate and is based on the information received to date from potential refuse contract providers. This strategy accounts for the financing of the fleet through a PWLB annuity loan over a period of 10 years with an estimated start date midway through 2016/17. The financing period has been selected at this stage based on the potential length of the contract and the life of the assets being used to deliver the current contract. Once the final fleet combination has been confirmed the financing period may change as relevant to each asset.

The Council currently finances the refuse fleet as part of the contract itself, however as this type of financing can be expensive, the Council commissioned Capita Asset Services to work with officers to identify a financing option that offered the best value for money for the residents of East Devon. Capita undertook a piece of work which compared the net present value of leasing the assets from the various interested parties or obtaining a separate finance lease, to the Council financing the assets directly. In every service provision scenario it was cheaper for the Council to finance the assets directly. When compared to financing the assets through the contract a saving of between £0.392 and £1.097m was identified dependent on the lot and contractor, and compared to borrowing through a separate finance lease the saving was between £0.221m and £0.362m. These savings were calculated over a seven year financing period, but still demonstrate the impact of the particularly low rates at which local authorities are able to borrow.

The inclusion of this item within the strategy based on an estimate prior to contract award allows Members to approve the necessary level of borrowing required for the full year without the need to bring a further paper later in 2016/17. This should ensure that the delivery of the contract is not delayed due to financing considerations.

In practice the borrowing strategy is dependent on the amount and timing of expenditure, given the market conditions at the time, and the capital financing requirement is likely to be funded via a combination of external fund disinvestment, and/or loans from PWLB.

3.2 Housing Revenue Account (HRA)

As at 31 December 2015 the HRA had 24 PWLB Loans totalling just over £84m. Of these, 23 are maturity loans (principal repayable at the end of the loan) varying in remaining duration from 1 - 23 years taken out under the Government's self financing regime. The 24th loan is an annuity loan (repaying principal each year) which was taken out in March 2011 for 17 new build properties. It is expected that the 2015/16 year-end position on these loans will be £83.4m.

The remaining capital balance on the 23 maturity PWLB loans will total £82.779m at the end of this financial year. The interest payments associated with these loans is £2.5m during this financial year.

The loan repayments have been profiled in line with the business plan, whereby the HRA generates resources to be able to repay the principal, with a balance being struck between repaying as soon as possible and allowing the HRA to generate sufficient surpluses as a cushion against uncertainties and enabling it to carry out improvements to stock.

On January 6th 2016 Cabinet was presented with a paper on the draft revenue and capital budgets. This paper outlined the impact of the summer budget announcement that authorities would be required to reduce HRA rental charges by 1% per annum for the next 4 years. The impact this has on the HRA business plan has led to a reconsideration of the current HRA self financing repayment schedule for 2016/17. During 2016/17 a repayment of principal of £1.5m is due. The proposal that of this £0.7m is refinanced has been reflected in this strategy as the repayment of the old loan and the drawdown of a new loan.

The HRA annuity loan will have an outstanding capital balance of £0.619m at the end of this financial year. During 2015/16 £0.039m was paid out against this loan which included interest of £0.006m. This loan is at a fixed rate of interest and includes an annual repayment of both principal and interest, which due to its nature vary each year depending on the loan balance.

The estimated effect of these Capital loans is an increase of £6.33 in the proportion of the Council’s Band D tax level used for capital financing costs. This increases from £2.10 in 2015/16 to £8.43 in 2016/17, (Table 8).

The actual effect of financing these loans on average weekly rents was £14.24 in 2014/15, (£11.15 in 2013/14), (Table 8).

3.3 Cash Flow or Temporary Borrowing

In addition to borrowing for capital purposes, the Council also borrows in the short-term to meet day to day shortages in its call account. This borrowing requirement is inherent within the operation of this account and is normally covered overnight via the call account overdraft and cleared the next day.

In some instances, particularly around the year end, the overdraft may not provide a sufficient short-term buffer, and in these instances the Council can borrow via the market at fixed rates for a fixed term of less than 3 months.

At the end of 2014/15 there was no requirement for short-term borrowing over the year end, and currently there is no indication that such borrowing will be required at the end of 2015/16.

3.4 Treasury Indicators: Limits to Borrowing activity

As part of the CIPFA code for Treasury Management it is recommended that the Council is informed of the anticipated borrowing limits required for the forthcoming financial year.

In addition to loans mentioned earlier, the Council will still need to make use of short term borrowing to meet day to day cash flow shortfalls.

The limits on the level of borrowings are stated below at 3.5 and 3.6.

3.5 The Operational Boundary for External Debt

This is the limit which external debt is not normally expected to exceed. This is the prudent level of external debt that the Council estimates will be required during any one year in terms of its capital financing and cash flow requirements. 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. The Council is asked to approve these limits and to delegate authority to the Section 151 Officer to be allowed to exceed these agreed limits if necessary, and report back to Cabinet, immediately after the event.

Table 9 shows both the actual operational boundary for external debt for 2014/15 and the estimates for 2015/16 to 2018/19. The operational boundary for any particular year has to be the higher of the opening and closing positions during that year.

Table 9. Operational Boundary for External Debt (Estimated)					
	Actual	**Per 16/17 Estimates**			
	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£000	**£000**	**£000**	**£000**	**£000**
Borrowing - General Fund	1,445	4,787	16,827	16,827	10,590
Other LTL's* - General Fund	361	361	0	0	0
General Fund Total	**1,806**	**5,148**	**16,827**	**16,827**	**10,590**
Borrowing - HRA	84,426	83,398	82,608	82,608	81,298
Other LTL's* - HRA	0	0	0	0	0
HRA Total	**84,426**	**83,398**	**82,608**	**82,608**	**81,298**
Overall Total	**86,232**	**88,546**	**99,435**	**99,435**	**91,888**

*****LTL's – Long Term Liabilities, e.g. Finance lease costs.

3.6 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.

There is also a statutory limit determined under section 3 (1) of the Local Government Act 2003. In this case 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 authorised limit is based on the Council's estimate of the most likely and prudent requirement for external debt (borrowing) during the year (the operational boundary) plus additional headroom for unanticipated cash movements, including those due to slippage.

For the General Fund the headroom is set at £3.0m.

For the HRA a debt cap of £87.844m set by the Government as the authorised limit has been used.

External debt is the sum of both debt to fund capital items, and short term borrowings to meet day to day cash flow variations.

In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt and to delegate authority to the Section 151 Officer (Strategic Lead Finance), to operate within the total limit for any individual year.

It is the duty of the Section 151 Officer to ensure that the authorised limits are consistent with the Council's current and future capital requirements. These limits should take account of risk management strategies, with regard to capital schemes and all future cash flow predictions, including the headroom referred to above for unexpected cash movements.

Table 10 shows the actual external debt for 2014/15 and the Authorised Limit for external debt for 2015/16 to 2018/19, based on estimates for capital expenditure and financing. The Council is asked to approve the following authorised limits:

Table 10. Authorised Limit for External debt (Estimated)					
	Actual	**Per 16/17 Estimates**			
	2014/15	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	£000	**£000**	**£000**	**£000**	**£000**
Borrowing - General Fund	1,445	7,787	19,827	19,827	13,590
Other LTL's* - General Fund	361	361	0	0	0
General Fund Total	**1,806**	**8,148**	**19,827**	**19,827**	**13,590**
Borrowing - HRA	84,426	87,844	87,844	87,844	87,844
Other LTL's* - HRA	0	0	0	0	0
HRA Total	**84,426**	**87,844**	**87,844**	**87,844**	**87,844**
Overall Total	**86,232**	**95,992**	**107,671**	**107,671**	**101,434**

*****LTL's – Long Term Liabilities, e.g. Finance lease costs.

The Council's actual external debt at 31 March 2015 was £86.23m (General Fund £1.80m and HRA £84.43m).

3.7 Prospects for Interest Rates

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

Appendix 1 provides the full detail of Capita's interest rate forecast and central view.

The key point to note being that the bank rate is currently forecast to increase from 0.5% to 0.75% during the quarter to June 2016 and then again to 1% during the quarter to December 2016.

3.8 Treasury Management Limits on Activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs and improve performance. 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; and,
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing within the same period, and the Council is required to agree upper and lower limits.

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

3.9 Interest Rate Exposure

Based on the projected investment and borrowing requirements of the Council over the next three years the upper limit on fixed and variable interest rate exposure is outlined in Table 11. These rates are consistent with those in the 2015/16 strategy.

Table 11. Interest Rate Exposure

	General Fund		HRA	
	Fixed	**Variable**	**Fixed**	**Variable**
2015/16 Limits				
Borrowing	100 %	20%	100%	20%
Investments	60%	100%	60%	100%
2016/17 Limits				
Borrowing	100%	20%	100%	20%
Investments	60%	100%	60%	100%
2017/18 Limits				
Borrowing	100%	20%	100%	20%
Investments	60%	100%	60%	100%

With the exception of the bank overdraft, all borrowing the Council undertakes is at a fixed rate of interest.

Investments have a 100% variable upper limit, as currently the majority of returns are variable including the external investment funds, 'savings' account, and money market fund investments. The fixed element of investments reflect fixed deposits, and non-treasury management, policy based investment decisions. All investments of this nature are on a fixed term basis, whereby any interest chargeable on a project is then recharged on to the project itself, the idea being that in cost terms there is a nil impact on the Council. The loan to LED as referred to elsewhere within this report is one such example of a policy based investment decision.

The upper limit on variable borrowing at 20% ensures a level of certainty for Council borrowing, and thus cash outflows. The upper limit on fixed investments helps to protect the council from interest rate risk. For example it is not in the best interests of the Council to have too much cash tied up in a fixed return investment in the event of an interest rate rise, which would mean better returns may be had elsewhere. Variable rate investments often track the base rate, thus removing the risk associated with upward interest rate changes.

3.10 Maturity Structure of Borrowing

This is the amount of projected long term capital borrowing that is due for repayment in each period expressed as a percentage of total borrowing. A limit is set to reduce the Council's exposure to large sums falling due in any one period.

At any point the actual percentages of debt projected to mature in each year will add up to 100%, but the proposed indicator is for a range of approved percentages. This gives discretion within an approved range to the treasury team. It does mean that each 'set' of figures will sum to more than 100%.

The council is asked to approve the following limits as outlined in Table 12:

Table 12. Limits on Maturity Structure of Fixed Rate Borrowing as % of Total Borrowing

		General Fund		HRA	
		Upper Limit	Lower Limit	Upper Limit	Lower Limit
Current Year	2015/16	20%	0%	20%	0%
Next yr	2016/17	20%	0%	20%	0%
Yr 2-5	2017/18 - 2020/21	65%	0%	20%	0%
Y6 -10	2021/22 - 2025/26	25%	0%	25%	0%
Y11+	2026/27 – 2055/56	20%	0%	75%	0%

The upper limit in the General Fund for year's two to five is due to the impact of cash flow timings associated with the repayment of the potential Queen's

Drive and relocation loans. These loans are funded from capital receipts associated with the projects and therefore do not represent a significant maturity risk to the Council.

Within the HRA the majority of the loans are over the longer term, as aligned to the HRA business plan, resulting in the upper limit being higher from 2026 onwards.

The upper limits on the maturity structure of borrowing will shift slightly each year as the maturity dates draw closer. However the limits shown are in line with expectations based on the funding plans.

The actual amounts maturing in each period are shown in Table 13 and reflect both the actual and potential loan commitments as referred to elsewhere within this strategy.

Based on capital borrowing plans included in the budget the current projected maturity structure of borrowing is shown in Table 13:

Table 13. Estimated Maturity Structure of Fixed Rate Borrowing as % of Total Borrowing

		General Fund		HRA	
		Projected Borrowing Amount Maturing £000	**Total**	**Projected Borrowing Amount Maturing £000**	**Total**
Current Year	2015/16	858	**4.45%**	1,029	**1.21%**
Next yr	2016/17	710	**3.68%**	1,490	**1.75%**
Yr 2-5	2017/18 - 2020/21	11,783	**61.16%**	7,074	**8.31%**
Y6 -10	2021/22 - 2025/26	3,878	**20.12%**	16,694	**19.61%**
Y11-20	2026/27 - 2035/36	1,960	**10.17%**	48,640	**57.14%**
Y21-30	2036/37 - 2045/46	81	**0.42%**	9,330	**10.96%**
Yr31-40	2046/47 - 2055/56	0	**0.00%**	870	**1.02%**
		19,270	**100.00%**	**85,127**	**100.00%**

In addition to the above, the Council has an overdraft limit of £0.35m and can, if required, borrow for periods less than 3 months at fixed rates, in order to meet daily cash flow requirements. The strategy is managed so as to avoid short term fixed borrowing where possible.

3.11 Upper Limit for Total Principal Sums Invested over 364 days

Only the Council's external funds can be invested for over 364 days and these total £30.92m. In practice the Council can access this money with 3 days notice.

3.12 Policy on Borrowing in Advance of Need

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

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

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.

Borrowing in advance will be made within the constraints that it will:

- be limited to no more than the expected increase in borrowing need;
- occur not more than 12 months (3 months 2015/16) in advance of need; and,
- be agreed with the Section 151 Officer and Portfolio Holder for Finance in advance.

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

The Council has not in the recent past borrowed in advance of need, however officers are considering this option in relation to the renewal of the refuse contract. The refuse contract requires the Council to purchase a significant amount of fleet, which has a variable lead time for delivery. This can be as much as 10 months. Once a fleet order has been placed there is a level of certainty associated with its purchase cost, but the actual cash is not usually paid out in full until delivery. Considering the potential fleet lead times against the forecast interest rate movements (Appendix One) officers have identified, that as interest rates are forecast to increase within the next year there would be some merit in assessing the benefits of borrowing sooner rather than later. Officers are in discussion with Capita Asset Services to this end, and once the final fleet details are known a sensitivity exercise will be carried out to identify if this is a worthwhile consideration.

It is therefore recommended that the borrowing in advance constraints are increased from 3 months to one year in order to facilitate the purchase of the refuse fleet, if this can be demonstrated to offer a sufficient saving commensurate to risk.

3.13 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 cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancing the balance of the portfolio (amending 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.

As referred to in 3.2 above the only rescheduling currently being considered is in relation to one HRA self-financing loan which is due for repayment in 2016/17. This is not a complex transaction and is likely to involve the repayment of the debt when it becomes due followed by the partial draw down of the capital repaid in a new loan. This is distinct from rescheduling partway through the loan term.

All rescheduling will be reported to Cabinet at the earliest meeting following its implementation.

4 Annual Investment Strategy

4.1 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 Sectoral Guidance Notes ("the CIPFA TM Code").

The Council's overriding investment policy objective is to prudently manage the Council's funds, ensuring that risks are minimised whilst maximising returns. The Council's investment priorities in order of importance are:

- Security of the invested capital
- Liquidity of the invested capital
- Yield (return on investment)

In accordance with the above objective and in order to minimise risk to the principal sums invested, the Council sets parameters which are assessed when considering the credit risk of potential counterparties to include on the lending list. These parameters include the minimum acceptable credit quality of counterparties, i.e.their creditworthiness, and their net asset value as applicable. The counterparty list also enables diversification and thus avoidance of concentration risk.

The creditworthiness methodology used to create the counterparty list takes account of the ratings, watches and outlooks published by three ratings agencies, as advised by CIPFA. The agency data used is that published by Fitch, Moody's, and Standard & Poors.

The Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and therefore other sources of information are used as relevant including:

- Financial press articles (macro-economic, banking, and individual institutions)
- Share price
- Other information pertaining to the banking sector
- Annual accounts of Building Societies

4.2 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 and criteria for choosing investment counterparties with adequate security, as well as monitoring that 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.

The Strategic Lead Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified and this list provides an overall pool of counterparties considered high quality which the Council may use, rather than defining the types of investment instruments that are to be used (i.e. cash, floating rate notes, and certificates of deposit).

Counterparty ratings are monitored on a real time basis via notifications received from Capita Asset Services as the agencies publish modifications. In addition a full review of the counterparty list is carried out on a regular basis.

The security of the Council's financial assets is paramount, and whilst the strategy needs to be clear in this area it also needs be sufficiently comprehensive and itterative in order to provide operational flexibility within, what at times, is a volatile macroeconomic environment. As the financial backdrop changes it is essential that the strategy is set to enable an efficient response to those changes.

The 2016/17 strategy allows for investments of up to £2.0m to be deposited with UK incorporated banks, or those banks entitled to receive UK deposits. However the reality is that the banks have not been willing to accept cash investments for the amounts and periods the Council has been able to offer. Market sentiment indicates that this will continue into the forseable future with the added risk that call account returns are likely to reduce. This demonstrates that whilst it is important to include a range of parameters within a comprehensive strategy it is also important to recognise the practicality of such parameters.

The Council manages the majority of its internal investments via money market funds and a range of building societies in line with the creditworthiness criteria referred to below.

In order to address the need for flexibilty, and to ensure the spread of risk, access to an investment portal has been arranged which allows officers to review and potentially transact with a small range of money market funds directly. All money market funds considered suitable with reference to the creditworthiness criteria will be approved for use by the Section 151 Officer before an account is opened. The Council currently has access to two money market funds, but officers are intending to open at least one more in the near future.

This strategy proposes to include corporate bonds within its creditworthiness criteria for the first time in 2016/17. The reason behind this is to provide further investment opportunities given the particularly low returns currently being offered by several of the building societies commonly used by EDDC. It is proposed that investments in corporate bonds would be limited to a duration of less than 1 year, be AAA rated, and have a maximum value of £2m per investee. The Council will not trade corporate bonds directly, but will trade via a specialist investment intermediary, whose fee is linked to the return. Given the short duration proposed it is anticipated the majority of trades will be via the secondary market.

A very difficult investment environment remains. Whilst counterparty risk appears to have eased, it remains at elevated levels and economic forecasts are abound with uncertainty. However, the UK also has a very accommodating monetary policy - reflected currently in a 0.5% bank rate.

EDDC's Treasury Management Strategy therefore needs to be sufficiently flexible to allow it to adapt to changing economic circumstance whilst ensuring the security of funds invested.

The Council's proposed creditworthiness criteria are included in the Table14 below.

Table 14. Creditworthiness Criteria		
Organisation	**Criteria**	**Max Amount**
External (Long Term) Investment Fund		
Collective investment schemes (e.g. bond funds)	AAA long-term rating backed up with lowest volatility rating (V1/S1)	60% of External Fund total
Cash Flow/Internal Investments		
Deposit Building Societies	With over £5 Billion in total assets	£3m
Deposit Building Societies	With over £1 Billion in total assets	£2m
Deposit with UK incorporated Banks	Minimum F1, A1 or P1 short term backed up by A long term credit rating	£2m

Deposit with Banks Incorporated outside the UK but entitled to accept deposits in UK	Minimum F1+, A1+ or P1+ short term backed up by AA- long term credit rating	£2m
Money Market Funds	AAA long-term rating	£3m
UK Local, Police & Fire Authorities		£3m
UK Government Treasury Bills/Gilts		No limit
Corporate Bonds	AAA and less than one year duration	£2m

The ‘deposits’ referred to in Table 14 refer to either cash, floating rate notes or certificates of deposit.

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.

As a consequence of these new methodologies the key ratings used to monitor counterparties are the short term and long term ratings only. Viability, Financial Strength and Support Ratings previously applied are effectively redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes. EDDC refers only to the short and long term ratings when assessing counterparies, as such its review of counterparty creditworthiness will not be affected by this regulatory change which has been referred to here for information only.

The Council will not invest in subsidiaries that do not have a credit rating in their own right and a separate FSA licence from the parent company.

In the event of a downgrade resulting in a counterparty or investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

Any changes in counterparty ratings or other criteria that put the counterparty below the minimum criteria whilst the Council holds a deposit will be brought to the attention of the Strategic Lead Finance and the Portfolio Holder for Finance immediately, with an appropriate response decided on a case-by-case basis.

The Council's current counterparty list is included at Appendix 3.

It is recommended that Cabinet approves the creditworthiness criteria above which have been updated in the current year to include the addition of corporate bonds.

4.3 Specified and Non-Specified Investments

Specified Investments are required to be in Sterling and have a maximum maturity of 1 year and be of 'high credit quality'.

The definition of 'high credit quality' is set out below:

- Investments in Banks Incorporated in the UK with a credit rating of at least A/F1, A1 or P1 with a limit of £2m on the amount invested.
- Investments in Banks Incorporated outside of the UK but entitled to accept deposits in the UK, per the Bank of England Prudential Regulation Authority list of banks, with a credit rating of at least AA-/F1+/A1+/P1 with a limit of £2m on the amount invested.
- Investments in collective investment schemes, including money market funds, structured as Open Ended Investment Companies (OEIC's) with a long term rating of AAA for Constant Net Asset Value (CNAV) funds and AAA V1/S1 for Variable Net Asset Values (VNAV).
- Internal Investments less than 6 months, up to agreed limits, in UK Building Society's with an asset basis of over £1 billion.
- Corporate bonds rated AAA of less than one year duration.

All investments over 1 year in duration and/or not meeting the definition of high credit quality listed above are classified as non-specified investments.

The Council limits non-specified treasury investments to 10% of the value of its investment portfolio at the point of investment, with the maximum amount invested being in line with criteria outlined in Table 14.

4.4 Current Investment and Borrowing Position

The current position on debt and investment principal as at 31 December 2015 is show in Table 15.

Table 15. Current Investment and Borrowing Position		
	£M	
Short Term Internal Investments		
Bank of Scotland call account	2.00	
Public Sector Deposit Fund (Money Market Fund)	0.05	
Goldman Sachs Sterling Liquidity (Money Market Fund)	0.15	
Fixed Term Cash Deposits < 1 Month	0.00	
Fixed Term Cash Deposits < 2 Month	9.00	
Fixed Term Cash Deposits < 3 Month	0.00	
Fixed Term Cash Deposits < 4 Month	0.00	
Fixed Term Cash Deposits < 5 Month	7.00	
Fixed Term Cash Deposits < 6 Month	1.00	
	19.2	**38.30%**
External Investments		
Royal London Asset Management - Cash Plus Fund	15.46	**30.85%**
Payden & Rygel - Sterling Reserve Fund	15.46	**30.85%**
	30.92	
Total Investments	**50.12**	
Borrowing		
Short Term Cash Flow Borrowing	0.00	
PWLB Loan (General Fund) < 10 years	2.07	
PWLB Loan (HRA) < 40 years	84.42	
	86.49	

4.5 Externally Managed Funds

The Council currently has over £30m invested, split equally between the following pooled investment vehicles, OEIC's:

- Cash Plus Fund – Royal London Asset Management (RLAM)
- Sterling Liquidity Fund – Payden & Rygel

4.6 Other investments

In addition to the aforementioned investments work is currently being undertaken to assess a range of potential project investments which as well as offering financial returns to the Council will also offer social benefits to the population of East Devon. Examples include investments in a district heating scheme, and in superfast broadband projects for hard to reach areas. Detailed reports will be presented to Cabinet in relation to such projects as they progress. At the same time the associated detailed treasury management implictions will also be reported.

4.7 End of year investment report

At the end of the financial year, the Council will be provied with a detailed report on its investment activity as part of the Annual Treasury Report.

5. Other Items

5.1 Use of Reserves

The draft 2016/17 budget has been compiled on the basis that the Council will make the following withdrawals from reserves:

	£000
General Fund Reserves	0
Capital Reserves	1,078
	1,078

The final amount to be withdrawn from reserves is subject to the final decision of Full Council on 24th February 2016.

The need to withdraw any further funds from the investment portfolio will be kept under review and assessed on a case by case basis with reference to the economic climate at the time.

6. Appendices

1. Interest rate forecasts
2. Economic background
3. Current counterparty list
4. The treasury management role of the Section 151 Officer

Appendix 1: Interest Rate Forecasts 2015 - 2018 (provided by Capita Asset Services as at 13 January 2016)

This information has been provided by Capita Asset Services. The following table and commentry gives their central view.

Capita Asset Services Interest Rate View													
	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%	0.75%	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	0.70%	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	0.90%	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	1.20%	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	2.40%	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	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	3.70%	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	3.60%	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%	0.75%	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%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	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	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	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%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	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%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	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%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

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 MPC will decide to make a start on increasing Bank Rate.

USA. *The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then 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 MPC.*

EZ. *In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a* *positive effect in helping a recovery in consumer and business confidence and a start to 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.*

Apendix 2: Economic Background (provided by Capita Asset Services as at 13 January 2016)

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 ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to 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.*

Appendix 3:

Internal Counterparty List 2015-16 as at 31 December 2015

Building Societies				
		Total Assets £'000	**Assets > £1 Billion**	**Max Investment £**
1	Nationwide	194,821,000	YES	3,000,000
2	Yorkshire	41,779,000	YES	3,000,000
3	Coventry	30,890,000	YES	3,000,000
4	Skipton	15,336,000	YES	3,000,000
5	Leeds	12,220,000	YES	3,000,000
6	Principality	7,108,000	YES	3,000,000
7	West Bromwich	5,570,000	YES	3,000,000
8	Newcastle	3,741,000	YES	2,000,000
9	Nottingham	3,267,000	YES	2,000,000
10	Cumberland	1,903,000	YES	2,000,000
11	Progressive	1,688,000	YES	2,000,000
12	National Counties	1,302,000	YES	2,000,000
13	Saffron	1,169,000	YES	2,000,000
14	Cambridge	1,154,000	YES	2,000,000
15	Monmouthshire	1,044,000	YES	2,000,000
Money Market Funds	CCLA - Public Sector Deposit Fund		AAA	3,000,000
	Goldman Sachs Sterling Liquidity Fund		AAA	3,000,000

Banks	UK or Irish bank with presence in UK and a short term Fitch rating of F1 or higher.			
UK High Street Banks		**Short Term Fitch Rating**		**Max Investment £**
	Lloyds Banking Group			
	Lloyds TSB	F1		2,000,000
	Bank of Scotland	F1		2,000,000
	Others			
	Santander UK PLC	F1		2,000,000
	Barclays	F1		2,000,000
	HSBC Bank plc	F1+		2,000,000
	Clydsdale Bank	F1		2,000,000

Non-UK Banks		Short Term Fitch Rating	LongTerm Fitch Rating	Max Investment £
	Abu Dhabi (U.A.E)			
	National Bank of Abu Dhabi	F1+	AA-	2,000,000
	Australia			
	Australia and New Zealand Banking Group Ltd	F1+	AA-	2,000,000
	Commonwealth Bank of Australia	F1+	AA-	2,000,000
	National Australia Bank Ltd	F1+	AA-	2,000,000
	Westpac Banking Corporation	F1+	AA-	2,000,000
	Canada			
	Bank of Montreal	F1+	AA-	2,000,000
	Bank of Nova Scotia	F1+	AA-	2,000,000
	Canadian Imperial Bank of Commerce	F1+	AA-	2,000,000
	Royal Bank of Canada	F1+	AA	2,000,000
	Toronto Dominion Bank	F1+	AA-	2,000,000
	Finland			
	Nordea Bank Finland plc	F1+	AA-	2,000,000
	Netherlands			
	Cooperatieve Centrale Raiffeisen Boerenleenbank BA (Rabobank Nederland)	F1+	AA-	2,000,000
	Singapore			
	DBS Bank Ltd	F1+	AA-	2,000,000
	United Overseas Bank Ltd	F1+	AA-	2,000,000
	Sweden			
	Svenska Handelsbanken AB	F1+	AA-	2,000,000
	U.S.A			
	Bank of New York Mellon, The	F1+	AA-	2,000,000
	Wells Fargo Bank NA	F1+	AA-	2,000,000
	UK Local, Police and Fire Authorities			3,000,000

Appendix 4: 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.