JOINT INDEPENDENT AUDIT COMMITTEE **22 FEBRUARY 2016**

TREASURY POLICY STATEMENT & TREASURY STRATEGY 2016/17 TO 2019/20

REPORT OF THE JOINT CHIEF FINANCE OFFICER

1 Purpose of the Report

1.1 To review and recommend the adoption by the Commissioner of the attached four year 2016/17 to 2019/20 Treasury Policy Statement and Strategy.

2 Background

2.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) has produced the Code of Practice on Treasury Management (the Code) which represents best practice in Treasury Management. By adopting the attached Treasury Policy Statement and Strategy for 2016/17 to 2019/20, as set out in Appendix 1, the Commissioner contributes towards achieving best practice.

2.2 Part 1 of the Local Government Act 2003 specifies the powers of local authorities to borrow for any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs. For the purpose of the Local Government Act 2003 Police and Crime Commissioners are classified as local authorities. The CIPFA Prudential Code for Capital sets out a range of prudential and treasury indicators that must be calculated to ensure borrowing is affordable, prudent and sustainable. The Prudential Code also refers to the need for a clear and integrated treasury strategy.

2.3 In addition, under Section 15 of the Local Government Act 2003, local authorities are required to have regard to the CLG's Guidance on Local Government Investments. This document stipulates the requirement for an annual investment strategy to be integrated into the Commissioner's Treasury Strategy.

3. Treasury Policy and Treasury Strategy

3.1 The Treasury Policy 2016/17 – 2019/20 is set out in Appendix 1, and details the overarching approach to the provision of Treasury Management which includes the Treasury Strategy, Investment Strategy and appropriate delegations.

3.2 The Treasury Strategy for 2016/17 to 2019/20 covers the specific activities proposed for the next fouryears in relation to both borrowing and investments and ensures a wide range of advice is taken to maintain and preserve all principal sums, whilst obtaining a reasonable rate of return, and that the most appropriate borrowing is undertaken. The primary objective of the investment strategy is to maintain the security of investments at all times. The Strategy is attached at Appendix 2 to this report.

3.3 The Treasury Strategy complies with the requirements of the Code, the Prudential Code for Capital Finance in Local Authorities and Part 1 of the Local Government Act 2003.

3.4 In addition, there are further Appendices 3 to 8, which set out the current interest rate forecasts, the economic background, Prudential Treasury Indicators, Specified Investments, Maximum Maturity Periods, and details of foreign countries that could be invested with, all of which underpin the core approach detailed in the Strategy.

4 Equal Opportunities Implications

4.1 It is considered that there are no equal opportunities implications arising from the report.

5 Human Rights Implications

5.1 It is considered that there are no human rights implications arising from the report.

6 Risk Management Implications

6.1 The Treasury Policy and Strategy recommended for approval have been prepared with the aim of maintaining the security and liquidity of investments to ensure that the Commissioner's principal sums are safeguarded. Maximising income is considered secondary to this main aim.

7 Financial Implications

7.1 There are no financial implications directly arising from the contents of this report. Any income and expenditure within the scope of the report is already included in the agreed revenue budget.

8 Recommendation

8.1 To recommend the adoption by the Commissioner of the attached four year 2016/17 to 2019/20 Treasury Policy Statement and Strategy.

9 Background Information

9.1 The following documents have been used in preparation of the report:

- Local Government Act 2003;
- CLG Guidance on Local Government Investments;
- CIPFA's Prudential Code for Capital;
- CIPFA's Code of Practice on Treasury Management;
- The approved Treasury Management Practice Statements as used for day to day management purposes;
- Capita Asset Services Treasury Management Strategy template 2016.

Appendix 1

Treasury Policy 2016/17 to 2019/20

1. Introduction

1.1 The Commissioner has adopted the key recommendations of CIPFAs Treasury Management in the Public Services: Code of Practice (the Code) and maintains:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of our treasury management activities;
- Suitable treasury management practices (TMPs), setting out the manner in which the policies and objectives are carried out, and prescribing how the activities will be managed and controlled.

1.2 CIPFA defines Treasury management as:

'The management of the Council'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.'

1.3 The Police and Crime Commissioner for Northumbria has delegated responsibility to the Chief Finance Officer (CFO) for the treasury management function and the undertaking of investment and borrowing on behalf of the Commissioner, ensuring that all activities are in compliance with the CIPFA Code of Practice for Treasury Management in the Public Services.

2. Treasury Strategy

2.1 The Commissioner 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 the risk implications for the Commissioner.

2.2 The Treasury Strategy encompasses the requirements of CIPFA’s Treasury Management Code of Practice, CIPFA’s Prudential Code and the CLG’s Guidance on Local Government Investments. This document stipulates the requirement for an annual investment strategy to be integrated into the Commissioner’s Treasury Strategy Statement.

2.3 The Treasury Strategy covers the following:

a) treasury limits in force which will limit the treasury risk and activities of the Commissioner, including prudential and treasury indicators;
b) prospects for interest rates;
c) the borrowing strategy;
d) debt rescheduling;
e) policy on borrowing in advance of need;
f) the investment strategy;
g) creditworthiness policy, and,
h) the policy on the use of external service providers.

2.4 The strategy for 2016/17 to 2019/20is attached at Appendix 2.

3. Prudential and Treasury Indicators

3.1 Under Part 1 of the Local Government Act 2003 the Commissioner may borrow money:
(a) for any purpose relevant to its functions under any enactment, or
(b) for the purposes of the prudent management of its financial affairs.

3.2 Under the requirements of the Prudential Code and Code of Practice on Treasury Management in the Public Services the following indicators have been adopted:
- Compliance with the Code of Practice on Treasury Management in the Public Services;
- Calculations of:
  - Authorised limit;
  - Operational boundary;
  - Actual external debt;
  - Upper limit on fixed interest rate exposures;
  - Upper limit on variable interest rate exposures;
  - Maturity structure of borrowing; and
  - Upper limits for principal sums invested for periods of over 364 days.

3.3 Given the link to the budget and capital programme, these indicators were approved by the Commissioner on 11th February 2016 as part of the 2016/17 Budget and council tax precept report. For completeness, the approved indicators are also attached to the Treasury Strategy at Appendix 5.

4. Annual Investment Strategy

4.1 Part 1 of the Local Government Act 2003 relaxed the investment constraints for local authorities.

4.2 The CLG has issued guidance to supplement the investment regulations contained within the Local Government Act 2003. It is also referred to under Section 15 (1) of the 2003 Local Government Act which requires authorities to "have regard (a) to such guidance as the Secretary of State may issue and (b) to such other guidance as the Secretary of State may by regulations specify". The guidance encourages authorities to invest prudently but without burdening them with the detailed prescriptive regulation of the previous regime.

4.3 Central to the guidance and the Code is the need to produce an annual investment strategy. This is included as Section 6 of the Treasury Strategy in Appendix 2.

4.4 The annual investment strategy document will include:
- The Commissioner's risk appetite in respect of security, liquidity and return;
- The definition of 'high' and 'non-high' credit quality to determine what are specified investments and non-specified investments;
- Which specified and non-specified instruments the Commissioner will use, dealing in more detail with non-specified investments given the greater potential risk;
- The categories of counterparties that may be used during the course of the year e.g. foreign banks, nationalised/part nationalised banks, building societies;
- The types of investments that may be used during the course of the year;
- The limit to the total amount that may be held in each investment type;

- The Commissioner's policy on the use of credit ratings, credit rating agencies and other credit risk analysis techniques to determine creditworthy counterparties for its approved lending list and how the Commissioner will deal with changes in ratings, rating watches and rating outlooks;
- Limits for individual counterparties, groups and countries; and
- Guidelines for making decisions on investments and borrowing.

5. Policy on Interest Rates Exposure

5.1 The 2016/17 Budget and Precept report, approved by the Commissioner on11 February 2016, sets treasury limits for the maximum and minimum level of exposure to fixed and variable interest rates. The use of any financial instruments, such as derivatives, to mitigate interest rate risks will be considered on an individual basis and the CFO will require approval from the Commissioner prior to entering into any arrangement of this nature.

6. Policy on External Managers

6.1 Treasury management advisers (Capita Asset Services, Treasury Solutions) assist us in achieving the objectives set out in the Treasury Policy Statement. This contract is reviewed annually. The CFO has not appointed external investment fund managers to directly invest the Commissioner's cash.

7. Policy on Delegation, Review Requirements and Reporting Arrangements

7.1 It is the Commissioner's responsibility under the Code to approve a treasury policy statement.

7.2 The Commissioner delegates the review of the policy, monitoring of the performance of the treasury management function and the scrutiny of treasury management strategy and policies to the Joint Independent Audit Committee, and the execution and administration of treasury management decisions to the CFO. Any proposals to approve, adopt or amend policy require the consent of the Commissioner and are matters for the Commissioner to determine.

7.3 The Commissioner will receive:

a) a three year Treasury Strategy report, including the annual Investment Strategy, before the commencement of each financial year;
b) a mid-year report on borrowing and investment activity, and
c) an annual report on borrowing and investment activity by 30 September of each year.

Appendix 2

Treasury Strategy 2016/17 to 2019/20

1. Introduction

1.1 The Treasury Strategy has been prepared in accordance with the Treasury Management Code of Practice (the Code). The Code emphasis a number of key areas including the following:

a) The Code must be formally adopted.
b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Commissioner's treasury management activities.
c) The Commissioner's appetite for risk, including the appetite for any use of financial instruments in the prudent management of those risks, must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.
d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.
e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support.
f) A sound diversification policy with high credit quality counterparties which considers setting country, sector and group limits.
g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.
h) The main annual treasury management reports must be approved by the Commissioner.
i) There needs to be a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.
j) Each Commissioner must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
k) Treasury management performance and policy setting should be subjected to prior scrutiny.
l) Commissioner's and scrutiny members dealing with treasury management activities should be provided with access to relevant training as those charged with governance are also personally responsible for ensuring they have the necessary skills and training.
m) Responsibility for these activities must be clearly defined within the organisation.
n) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Commissioner.

1.2 The management of day to day working capital (cash flow) including the requirement for temporary borrowing and/or investment will be monitored along with the limits noted below.

1.3 The Commissioner will adopt the following reporting arrangements in accordance with the requirements of the revised Code:

Area of Responsibility	**Commissioner/ Committee/ Officer**	**Frequency**
Treasury Management Policy & Strategy / Annual Investment Strategy	Commissioner with review delegated to Joint Independent Audit Committee	Annually before the start of the year
Annual Report	Commissioner with review delegated to Joint Independent Audit Committee	Annually by 30 September after the end of the year
Scrutiny of treasury management performance via mid-year report	Commissioner with review delegated to Joint Independent Audit Committee	Mid-Year
Scrutiny of treasury management strategy, policies and procedures	Joint Independent Audit Committee	Annually before the start of the year
Treasury Management Monitoring Reports	CFO	Monthly/Weekly
Treasury Management Practices	CFO	Monthly

1.4 The revised Treasury Management Code covers the following Prudential Indicators which were approved by the Commissioner on 11 February 2016:

- Authorised limit for external debt
- Operational boundary for external debt
- Actual external debt
- Upper limits on fixed and variable rate exposure
- Upper and lower limits to the maturity structure of borrowing
- Upper limits to the total principal sums invested longer than 364 days.

1.5 In addition to the above indicators, where there is a significant difference between the net and the gross borrowing position the risk and benefits associated with this strategy will be clearly stated in the annual strategy.

1.6 The strategy covers:

a) Prospects for interest rates;
b) Treasury limits in force which will limit the treasury risk and activities of the Commissioner, including prudential and treasury indicators;
c) The borrowing strategy;
d) Sensitivity forecast;
e) External and internal borrowing;
f) Debt rescheduling;
g) Policy on borrowing in advance of need;
h) The investment strategy; and
i) The policy on the use of external service providers.

2. Prospects for Interest Rates

2.1 The table shown below outlines the Commissioner's view of anticipated movements in interest rates, based on guidance received from the Commissioner's treasury management advisers Capita Asset Services, and various brokers. *(Updated CAPITA report 09/02/2016) (Includes a 20 basis point 'certainty rate' discount effective 1/11/2012).* A more detailed interest rate forecast is shown in Appendix 3.

	March 2016	June 2016	Sept 2016	Dec 2016	March 2017	March 2018	March 2019
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.25%	1.75%
5 yr PWLB*	2.00%	2.10%	2.20%	2.30%	2.40%	2.80%	3.20%
10 yr PWLB	2.60%	2.70%	2.80%	2.90%	3.00%	3.40%	3.70%
25 yr PWLB	3.40%	3.40%	3.50%	3.60%	3.70%	4.00%	4.10%
50 yr PWLB	3.20%	3.20%	3.30%	3.40%	3.50%	3.90%	4.00%

* Public Works Loan Board, a statutory body operating within the UK Debt Management Office, which is an executive agency of HM Treasury. The PWLB's function is to lend money to other prescribed public bodies.

Economic Background

2.2 **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 although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2.2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before weakening again to +0.4% (2.1% y/y) in quarter 3 followed by a slight recovery in quarter 4 to an initial reading of +0.5%. The Februaryr Bank of England Inflation Report included a forecast for growth to remain around 2.2 – 2.4% 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. However, these forecasts are approximately 0.2% lower than those of the November Inflation Report Investment expenditure is also expected to support growth. However, since the second half of 2015, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK and this theme was maintained in the February Inflation Report.

The February Inflation Report was notably subdued in respect of the forecasts for inflation in the near-term; this was expected to barely get back up to the 1% level within the next 12 months but was expected to marginally exceed the 2% target on the 2-3 year time horizon. The increase in the November Inflation Report 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 and commodity prices will delay a significant tick up in inflation from around zero. 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 is also the uncertain impact of the EU referendum which may take place as early as June 2016.

The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have consequently led to forecasts for when the first increase in Bank Rate would occur being pushed back to quarter 4 of 2016. There is downside risk to this forecast i.e. it could be pushed further back and the markets are currently betting on a mid 2017 increase.

- 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 withany new borrowing thatcauses an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

2.3 Further detail on the current economic climate and be found in Appendix 4.

Long Term Interest Rates

2.4 Following advice from Capita Asset Services treasury management advisers, the Commissioner's view on longer term fixed interest rates is that there will be little difference between the 25 year and 50 year rates which are expected to remain around 3.45% throughout 2016/17. It is also expected that PWLB interest rates on loans less than ten years in duration will be lower than longer term loans.

3. Treasury Limits for 2016/17 to 2019/20 including Prudential Indicators

3.1 It is a statutory requirement of the Local Government Finance Act 1992, for the Commissioner to produce a balanced budget. In particular, Section 31(a), as amended by the Localism Act 2011, requires the Commissioner to calculate the budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from increases in interest charges and increases in running costs from new capital projects are limited to a level, which is affordable within the projected income of the Commissioner for the foreseeable future.

3.2 It is a statutory duty under Section 3 of Part 1 of the Local Government Act 2003**,** and supporting regulations, for the Commissioner to determine and keep under review how much it can afford to borrow. The amount so determined is termed the Affordable Borrowing Limit. The Authorised Limit represents the legislative limit specified in the Act.

3.3 The Prudential Code for Capital Finance in Local Authorities is a professional code that sets out a framework for self-regulation of capital spending, in effect allowing Commissioners to invest in capital projects without any limit as long as they are affordable, prudent and sustainable.

3.4 The Commissioner must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires the Commissioner to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is affordable.

3.5 To facilitate the decision making process and support capital investment decisions the Prudential Code and the Treasury Management Code requires the Commissioner to agree and monitor a minimum number of prudential indicators.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.

3.6 These 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.

3.7 These indicators have been reviewed and updated and were approved by the Commissioner on 11 February 2016. They can be found attached at Appendix 5.

3.8 The CFO has systems in place to monitor the treasury limits and will report to the Commissioner instances where limits are breached, with the exception of short-term breaches of the Operational Boundary. The Operational Boundary is set so that if breached it acts as an early warning of the potential to exceed the higher Authorised Limit and as such temporary breaches due to debt restructuring and temporary borrowing are acceptable, providing they are not sustained.

4. Borrowing Strategy

4.1 The Local Government Act 2003 does not prescribe approved sources of finance, only that borrowing may not, without the consent of HM Treasury, be in other than Sterling.

4.2 The main options available for the borrowing strategy for 2016/17 are PWLB loans, market loans and an option to use the Municipal Bond Agency. The interest rate applicable to either PWLB or markets loans can be fixed or variable.

4.3 Variable rate short term borrowing is expected to be cheaper than long term fixed borrowing and therefore may be considered throughout the financial year. Due to the expectation that interest rates will rise, the risk of the potential increase in interest rates will be balanced against any potential short term savings.

4.4 There are different types of market loans available, including variable and fixed interest rate loans and Lender Option/Borrower Option (LOBO) loans. A LOBO is a loan where the lender can exercise their right to increase the interest rate of the loan at each call date. The borrower can then choose to either accept the higher interest rate or repay the loan. These loans are usually offered at an interest rate lower than the corresponding PWLB loan rate but this option increases the risk that it may be necessary to replace a loan at a time when the interest rates are high.

4.5 To mitigate this risk a limit is placed on the total level of borrowing that can be taken as variable interest rate loans. To provide scope to utilise new market products should they become available as well as minimise the cost of borrowing and increase the diversification of the debt portfolio it is proposed that the limit on variable rate loans should be 40% of total borrowing 2016/17.

The Commissioner is in the process of rationalising the estate and is expecting around £30m from the sale of assets over the term of this strategy. In light of this any borrowing decisions will need to take this into account.

4.6 The main strategy is therefore:

- Consider the use of short term borrowing as a bridge until receipts are received.
- Consideration will be given to borrowing market loans which are at least 20 basis points below the PWLB target rate, where they become available.
- When PWLB rates fall back to or below Capita Asset Services trigger rates borrowing should be considered, with preference given to shorter terms to enhance the diversity of the borrowing portfolio.

4.7 In addition, reserve and fund balances may be utilised to limit the new external borrowing requirement, or to make early debt repayments, as an alternative to investing these resources. Reducing investment balances rather than increasing external borrowing could reduce interest payable, as short term rates on investments are likely to be lower than rates paid on external borrowing, and limit exposure to investment risk.

Sensitivity of the Forecast

4.8 The Commissioner, in conjunction with Capita Asset Services, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to any changes. The main sensitivities of the forecast are likely to be the two scenarios below:

- *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 an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an 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 are still lower than they will be in the next few years.

- *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

4.9 Against this background, caution will be adopted in the management of the 2016/17 treasury operations. The CFO will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances having delegated powers to invest and manage the funds and monies of the Commissioner.

External and Internal Borrowing

4.10 As at 05 February 2016 the Commissioner has net debt of £82.586m; this means that borrowing is currently higher than investments with total borrowing of £102.465m and investments of £19.879m.

4.11 Investment interest rates are expected to be below long term borrowing rates throughout 2016/17 therefore value for money considerations indicate that best value can be obtained by delaying new external borrowing and by using internal cash balances to finance new capital expenditure in the short term (this is referred to as internal borrowing). Any short term savings gained from adopting this approach will be weighed against the potential for incurring additional long term costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be higher.

4.12 The CFO has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. The significant difference between early redemption rates and interest rates payable on PWLB debt means that large premiums are likely to be incurred by such action. This situation will be monitored in case the differential is narrowed by the PWLB.

Borrowing in advance of need

4.13 The Commissioner will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. In accordance with the revised Code, any decision to borrow in advance will be considered carefully to ensure value for money. Specifically, there will be a clear link to the capital investment programme, which supports the decision to take funding in advance of need.

4.14 **Municipal Bond Agency**

It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). The Commissioner will consider making use of this new source of borrowing as and when appropriate.

5. Debt Rescheduling

5.1 Any rescheduling opportunities will be considered in line with procedures approved under the Treasury Management Practice Statements and will include a full cost/benefit analysis of any proposed variations. Any positions taken via rescheduling will be in accordance with the strategy position outlined in Section 4 above and will also take into account the prudential and treasury limits.

5.2 The reasons for any proposed rescheduling will include:
- the generation of cash savings at minimum risk; and
- in order to amend the maturity profile and/or the balance of volatility in the Commissioner's borrowing portfolio.

5.3 The CFO in line with delegated powers outlined in the approved Treasury Management Practice Statement will approve all debt rescheduling.

5.4 As short term borrowing rates are expected to be lower than longer term rates, there may be opportunities to generate savings by switching from long term debt to short term debt. Opportunities identified will take into consideration the likely cost of refinancing these short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

5.5 Consideration will also be given to the potential for making savings by running down investment balances by repaying debt prematurely as short term rates on investments are likely to be lower than rates paid on currently held debt. However, this will need careful consideration in the light of premiums that may be incurred by such a course of action and other financial considerations.

5.6 All rescheduling will be reported to Commissioner in the mid-year and annual reports.

6. Investment Strategy 2016/17 to 2019/20

Introduction

6.1 The Commissioner has regard to the CLG's Guidance on Local Government Investments and CIPFA's Code of Practice. The Commissioner must produce a strategy on an annual basis which covers the subsequent four year period.

6.2 This annual strategy 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 in Appendix 6.The policy also ensures that 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 are detailed in Appendix 7.

6.3 The Commissioner will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them 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 Commissioner may use, rather than defining what types of investment instruments are to be used.

6.4 Specified investments are denominated in Sterling, are for periods of 364 days or less and do not involve the acquisition of share or loan capital in any body corporate. Such an investment will be with either:

- the UK Government or a local authority, parish or community council, or
- a body or investment scheme which has been awarded a high credit rating by a credit rating agency.

6.5 Non-specified investments are deemed more risky and guidance on local government investments requires more detailed procedures. Such procedures are required in order to regulate prudent use and establish maximum amounts which may be invested in each category.

6.6 Both specified and non-specified investment types currently utilised by the Commissioner are detailed in Appendix 6, along with approved limits. In addition to these numerous other investment options are available for use and these may be considered suitable for use in the future. Should this be the case then the options will be evaluated in line with the procedures contained within the approved Treasury Management Practice Statement.

Investment Objectives

6.7 All investments will be in Sterling.

6.8 The Commissioner's primary investment objective is the security of the capital investment. The Commissioner will also manage the investments to meet cash flow demands and to achieve a reasonable return commensurate with the proper levels of security and liquidity. The risk appetite of the Commissioner is low in order to give priority to security of its investments.

6.9 The borrowing of monies purely to invest is unlawful and the Commissioner will not engage in such activity.

Changes to the Credit Rating Methodology

6.10 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

6.11 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.

6.12 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. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA+. 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.

6.13 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.

Creditworthiness Policy

6.14 The creditworthiness service provided by Capita Asset Services is used to assess the creditworthiness of counterparties. The service provided by Capita Asset Services uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody’s and Standard and Poor’s, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following information as overlays which are combined in a weighted scoring system:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap spreads, financial agreements that compensate the buyer in the event of a default, which give an early warning of likely changes in credit ratings; and
- Sovereign ratings to select counterparties from only the most creditworthy countries.

6.15 The end product of this modelling system is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Commissioner to determine the duration for investments and are therefore referred to as durational bands. The Commissioner is satisfied that this service gives the required level of security for its investments. It is also a service which the Commissioner would not be able to replicate using in-house resources.

6.16 Sole reliance will not be placed on the use of this external service. In addition the Commissioner will also use market data and information, information on government support for banks and the credit ratings of the government support.

6.17 The Commissioner has also determined the minimum long-term, short-term and other credit ratings it deems to be “high” for each category of investment. These “high” ratings allow investments of 364 days or less to be classified as **specified investments**. The Commissioner’s approved limits for this “high” credit rating for deposit takers are as follows:

High Rated	**Fitch**	**Moody’s**	**Standard & Poor’s**
Short term (ability to repay short term debt)	F1	P1	A1
Long term (ability to repay long term debt)	AA-	Aa3	AA-

6.18 To ensure consistency in monitoring credit ratings throughout 2016/17 the Commissioner will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties, as the credit rating agency issuing the lowest rating could change throughout the year as agencies review the ratings that they have applied to countries, financial institutions and financial products. The ratings of all three agencies will be considered, with Fitch being used as a basis for inclusion on the lending list. In addition to this the CAPITA Asset Services creditworthiness service will be used to determine the duration that deposits can be placed for. This service uses the ratings from all three agencies, but by using a scoring system, does not give undue consideration to just one agency's ratings.

6.19 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Capita Asset Services weekly credit list of worldwide potential counterparties. The maximum maturity periods and amounts to be placed in different types of investment instruments are detailed in Appendix 7.

6.20 UK Government nationalised/part nationalised banks will have a maximum limit of 25% or £20m of total investment, all other counterparties will not exceed a maximum limit equal to 20% of total investments or £20m. Unless there are major changes in the level of investment balances throughout the year this limit will be reviewed prior to the commencement of each financial year.

6.21 Where more than one counterparty from a group is included on the counterparty list the group in total will be controlled by the above limits with the maximum limit being that of the parent company. Within the group each counterparty/subsidiary will have individual limits based on their creditworthiness although the total placed with the subsidiaries will not exceed the limit of the parent company. Subsidiaries that do not satisfy the minimum credit criteria will not be included.

6.22 A number of counterparties are also approved by the CFO for direct dealing. These counterparties are included on the approved list and dealing will be within agreed limits. Direct dealing with individual counterparties must be approved by the CFO prior to investments being placed.

Nationalised/Part Nationalised Banks

6.23 A number of banks in the UK do not conform to the credit criteria usually used to identify banks that are of high credit worthiness. In particular, as they are no longer separate institutions in their own right it is impossible for an individual rating to be assigned to them. Due to Government ownership these institutions now have the highest short-term rating possible as they effectively take on the creditworthiness of the Government and deposits placed with them are effectively with the Government. Taking this into consideration they have the highest rating possible. As a result of this when deposits are being considered with these counterparties the limits will be in accordance with the Capita Asset Services creditworthiness list.

6.24 Where the bank has not been fully nationalised but receives substantial support from the UK Government (greater than 40% ownership) the individual rating of the bank will not be taken into consideration and the relevant banks will be included on the Commissioner's lending list as prescribed by the Capita Asset Services creditworthiness list as detailed from paragraph 6.14.

Foreign Banks

6.25 Only banks domiciled in countries with a minimum sovereign rating of AA+ will be considered for inclusion on the approved list, they must also meet the high rated lending criteria and have operations based in London. Limits will be prescribed by the Capita Asset Services creditworthiness list and limited to 364 days or less. Each country will be limited to the maximum investment limit of £20m or 20% of the Commissioner's total investments. A list of those countries with a minimum sovereign rating of AA+ are shown in Appendix 8.

Local Authorities

6.26 The Commissioner invests with other Local Authorities on an ad hoc basis; each investment is considered on an individual basis and agreed by the CFO, prior to funds being placed. Limits are detailed at Appendix 7.

Non-specified Investments

6.27 In addition to the above specified investments, the Commissioner has also fully considered the increased risk of **non-specified investments** and has set appropriate limits for non-high rated deposit takers. These are as follows:

Non High Rated	Fitch	Moody's	Standard & Poor's
Short term	F1	P1	A1
Long term	A-	A3	A-

6.28 Limits for non-high rated counterparties and non-rated building societies are detailed at Appendix 7.

6.29 The credit ratings will be monitored as follows:

- All credit ratings are reviewed weekly. The Commissioner has access to Fitch, Moody's and Standard and Poor's credit ratings and is alerted to changes through its use of the Capita Asset Services creditworthiness service. On-going monitoring of ratings also takes place in response to ad-hoc e-mail alerts from Capita Asset Services.
- If a counterparty's or deposit scheme's rating is downgraded with the result that it no longer meets the Commissioner's minimum criteria, the further use of that counterparty/deposit scheme as a new deposit will be withdrawn immediately.
- If a counterparty is upgraded so that it fulfils the Commissioner's criteria, its inclusion will be considered for approval by the CFO.

6.30 Sole reliance will not be placed on the use of this external service. In addition the Commissioner will also use market data and information on government support for banks and the credit ratings of government support.

Investment Balances / Liquidity of investments

6.31 The Commissioner deposits funds beyond 364 days to a maximum of three years. This will continue where the counterparty is deemed to be a low credit risk to ensure a good rate of return is maintained in the current market conditions. Deposits beyond 364 days will only be considered when there is minimal risk involved. With deposits of this nature there is an increased risk in terms of liquidity and interest rate fluctuations. To mitigate these risks a limit of £15m (20% of total investments) has been set and a prudential indicator has been calculated (See Appendix 5). Such sums will only be placed with counterparties who have the highest available credit rating or other local authorities.

6.32 Deposits for periods longer than 364 days are classed as **non-specified investments** and this will increase the total limit of overall deposits in this classification to 75%.

Investments defined as capital expenditure

6.33 The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as **'non-specified investments'**.

6.34 A loan or grant by the Commissioner to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by the Commissioner. It is therefore important for the Commissioner to clearly identify if the loan was made for policy reasons (e.g. to a registered social landlord for the construction/improvement of dwellings) or if it is an investment for treasury management purposes. The latter will be governed by the framework set by the Commissioner for 'specified' and 'non-specified' investments.

Internal Investment Strategy

6.35 The CFO will monitor the interest rate market and react appropriately to any changing circumstances.

6.36 The Commissioner takes the view that base rate will remain at 0.50% before starting to rise from quarter 4 of 2016 so short term deposits, up to 364 days, will be utilised to cover cash flow and minimise risk to the Commissioner. Bank rate forecasts for financial year end are 2016/17-0.75%, 2017/18- 1.25% and 2018/19-1.75%.

6.37 The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and/or forecasts for increase in inflation rise, there could be an upside risk.

6.38 The Commissioner will avoid locking into longer term deals while investment rates are down at historically low levels. Long term deposits, beyond 364 days, will only be used where minimal risk is involved and the counterparties are considered to be supported by the UK Government.

Investment Risk Benchmark

6.39 The commissioner will use an investment benchmark to assess the investment performance of its investment portfolio against the 7 day LIBID.

End of year investment report

6.40 By the end of September each year the PCC will receive a report from Joint Audit Committee on its investment activity as part of its annual treasury report.

Policy on use of external service providers

6.41 The Commissioner uses Capita Asset Services, Treasury Solutions as its external treasury management advisers.

6.42 The Commissioner 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.

6.43 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 Commissioner 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.

Scheme of Delegation

6.44 As required by the Guidance Notes for Local Authorities the Treasury Management Scheme of Delegation is detailed below:

Commissioner
- Set and approve treasury management policy and strategy prior to the start of each financial year;
- Approve prudential and treasury indicators and any subsequent amendments if required;
- Agree and approve annual treasury management budgets;
- Approve any proposed variations in treasury strategy or policy;
- Agree annual report;
- Monitor Prudential and Treasury Indicators; and
- Receive and review monitoring reports including the annual report and act on recommendations.

Audit Committee
- Scrutinise the treasury management strategy, policies and practices and make recommendations to the Commissioner;
- Receive and review monitoring reports including the annual report; and
- Scrutinise and approve the mid-year monitoring report.

Role of the Section 151 Officer (Chief Finance Officer)

As required by the Guidance Notes for Local Authorities the role of the Section 151 Officer in relation to treasury management is detailed below.
- Recommending the Code of Practice to be applied, 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; and

- Recommending the appointment of external service providers

7. **Other Issues**

Heritable Bank Deposits

7.1 When Heritable Bank entered administration in October 2008 the former Police Authority had £5.238m invested which was due to mature with interest by the end of 2008/09; the total value including accrued interest was £5.300m.

7.2 To date dividends totalling £5.194m have been received representing 98p in the £ and the balance of the investment outstanding is therefore £0.106m.

7.3 The most recent update from the administrators, Ernst and Young, confirmed that they do not intend to make any further distributions of dividend until the resolution of the ongoing litigation of their claim with Landsbanki.

Appendix 3

Interest Rate Forecasts 2016 – 2019

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012. (Rates below as at 20th January 2016).

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

Economic Background Appendix 4

UK. UK GDP growth rates 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 although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2.2%. Quarter 1 2015 was weak at +0.4% (+2.9% y/y), although there was a slight increase in quarter 2 to +0.5% before weakening again to +0.4% (+2.1% y/y) in quarter 3 and then picking up to +0.5% (2.2%) in quarter 4.

The Bank of England's February Inflation Report included a forecast for growth to remain around 2.2% – 2.4% 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 5.1%.

Since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK. Bank of England Governor Mark Carney has set three criteria that need to be met before he would consider making a start on increasing Bank Rate. These criteria are patently not being met at the current time, (as he confirmed in a speech on 19 January):

- *Quarter-on-quarter GDP growth is above 0.6% i.e. using up spare capacity. This condition was met in Q2 2015, but Q3 came up short and Q4 looks likely to also fall short.*
- *Core inflation (stripping out most of the effect of decreases in oil prices), registers a concerted increase towards the MPC's 2% target. This measure was on a steadily decreasing trend since mid-2014 until November 2015 @ 1.2%. December 2015 saw a slight increase to 1.4%.*
- *Unit wage costs are on a significant increasing trend. This would imply that spare capacity for increases in employment and productivity gains are being exhausted, and that further economic growth will fuel inflationary pressures.*

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, subsequent round of falls in fuel and commodity prices which will delay a significant tick up in inflation from around zero. According to the February Inflation Report, CPI inflation is now expected to get back to around 1% by the end of 2016 but not get near to 2% until the latter part of 2017.

However, with the price of oil having fallen further in January 2016, and with sanctions having been lifted on Iran, enabling it to sell oil freely into international markets, there could well be some further falls still to come in 2016. The price of other commodities exported by emerging countries could also have downside risk and several have seen their currencies already fall by 20-30%, (or more), over the last year. These developments have led to the Bank of England lowering the pace of increases in inflation in its February 2016 Inflation Report. On the other hand, the start of the national living wage in April 2016 (and further staged increases until 2020), will raise wage inflation; however, it could also result in a decrease in employment so the overall inflationary impact may be muted. For now, the Bank of England is forecasting further falls in unemployment to circa 4.8%.

Confidence is another big issue to factor into forecasting. Recent volatility in financial markets could dampen investment decision making as corporates take a more cautious view of prospects in the coming years due to international risks. This could also impact in a slowdown in increases in employment. However, consumers will be enjoying the increase in disposable incomes as a result of falling prices of fuel, food and other imports from emerging countries, so this could well feed through into an increase in consumer expenditure and demand in the UK economy, (a silver lining!). Another silver lining is that the UK will not be affected as much as some other western countries by a slowdown in demand from emerging countries, as the EU and US are our major trading partners.

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 rates ought to rise sooner and quicker, 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 aggressively 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 over the last year from Q4 2015 to Q4 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. There has also been an increase in momentum towards holding a referendum on membership of the EU in 2016, perhaps as early as June, rather than in 2017; this could impact on MPC considerations to hold off from a first increase until the uncertainty caused by it has passed.

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 +2.0% in Q3 and then retreating to +0.7% in Q4.

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 (and December was outstanding); 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. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

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 their majority of seats. A left wing / communist anti-austerity coalition has won a majority of seats in Portugal. The general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. 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 and the start of 2016 in implementing several stimulus measures to try to ensure the economy hits the growth target of about 7% for 2015. It has also sought to bring some stability after the major fall in the onshore Chinese stock market during the summer and then a second bout in January 2016. 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 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, there are growing concerns about whether the Chinese economy could be heading for a hard landing and weak progress in rebalancing the economy from an over dependency on manufacturing and investment to consumer demand led services. There are also concerns over the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September and again in January 2016, which could lead to a flight to quality to bond markets. In addition, the international value of the Chinese currency has been on a steady trend of weakening and this will put further downward pressure on the currencies of emerging countries dependent for earnings on exports of their commodities.

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 a path of rising interest rates and bond yields.

The currencies of emerging countries have therefore been depressed by both this change in investors' strategy, and the consequent massive reverse cash flow, and also by the expectations of a series of central interest rate increases in the US which has caused 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 by a simultaneous downturn in demand for their exports and deterioration in the value of their currencies. 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. Capita Asset Services undertook its last review of interest rate forecasts on 19 January 2016. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time . 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 4 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. At some future point in time, an increase in 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 to the downside, given the number of potential headwinds that could be growing on both the international and UK scene. 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 January 2016, (based on short sterling), for the first Bank Rate increase are currently around quarter 2 2017.

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

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a flight to safe havens
- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK’s main trading partners - the EU and US A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

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 pace and timing 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.

Prudential Indicators –Treasury Management Appendix 5

Authorised Limit For External Debt				
	2016/17 £000	**2017/18 £000**	**2018/19 £000**	**2019/20 £000**
Borrowing	185,000	181,000	175,000	175,000
Other Long term Liabilities	0	0	0	0
Total	**185,000**	**181,000**	**175,000**	**175,000**

This represents a limit beyond which external debt is prohibited, 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.

Operational Boundary For External Debt				
	2016/17 £000	**2017/18 £000**	**2018/19 £000**	**2019/20 £000**
Borrowing	160,000	156,000	150,000	150,000
Other Long term Liabilities	0	0	0	0
Total	**160,000**	**156,000**	**150,000**	**150,000**

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 Capital Finance Requirement, but may be lower or higher depending on the levels of actual debt.

Treasury Indicators

Upper Limit on Fixed and Variable Interest Rates Exposures

Range	**2016/17 £000**	**2017/18 £000**	**2018/19 £000**	**2019/20 £000**
Fixed Rate:				
Upper	147,188	120,767	122,104	121,188
Lower	4,956	376	(5,540)	(10,540)
Variable Rate:				
Upper	6,000	6,000	6,000	6,000
Lower	(45,000)	(45,000)	(45,000)	(45,000)

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

Upper and Lower Limits for the Maturity Structure of Borrowings

	Upper Limit	Lower Limit
Under 12 months	65%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	60%	0%
10 years and above	75%	0%

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.

Upper Limit on Amounts Invested Beyond 364 Days				
	2016/17 £000	**2017/18 £000**	**2018/19 £000**	**2019/20 £000**
Investments	15,000	15,000	15,000	15,000

Appendix 6

Specified Investments (All Sterling Denominated)

Investment type	**Share/ Loan Capital**	**Repayable/ Redeemable within 12 months**	**Security / Minimum Credit Rating**	**Capital Expenditure**	**Circumstance of use**	**Maximum period**
Term deposits with the UK Government(DMO) or with UK Local authorities (i.e. local authorities as defined under Section 23 of the 2003 Act) with maturities up to 364 days.	No	Yes	High security although LA's not credit rated. *See section 6*	No	In-house	364 days
Term deposits with credit-rated deposit takers (banks and building societies), including callable deposits with maturities up to 364 days.	No	Yes	Secure Varied minimum credit rating *See section 6*	No	In-house	364 days
Money Market Funds (including 7 day notice account) These funds are instant access and therefore do not have a maturity date.	No	Yes	Secure AAA long-term rating backed up with lowest volatility rating (MR1+) with assets <£1bn	No	In-house	The investment period is subject to liquidity and cash flow requirements. It is assumed that funds are placed overnight and will be returned and reinvested the next working day (although no actual movement of cash may take place).

Non-Specified Investments (All Sterling Denominated)

Investment type	(A) Why use it (B) Associated risks	Share/ Loan Capital	Repayable/ Redeemable within 12 months	Security / Minimum credit rating	Capital Expenditure	Circumstance of use	Max % of overall investments	Maximum maturity of investment
Rated deposit takers (banks and building societies) which do not meet the Commissioner's "high" credit rating	(A) To improve ability to place smaller amounts (B) Greater risk than "high" credit rating counterparties but advance warning by rating agency of potential problems. The Commissioner has fully considered this investment category and set appropriate investment and maturity limits in order to minimise risk.	No	Yes	Secure Varied minimum Credit rating *Minimum: Fitch* *Long term A-* *Short term F1*	No	In-house	75%	6 months (but set on an individual counterparty basis)
Term depositswith UK Government, UK Local Authorities or credit rated banks and building societies, with maturities over 1 year	A) To improve the ability to "lock in" at times of high interest rates to secure a higher return over a longer period should rates be forecast to fall. B) Lower liquidity and greater risk of adverse interest rate fluctuations. The Commissioner has fully considered this investment category and set appropriate investment and maturity	No	No	Secure Varied minimum credit rating	No	In-house	20%	3 years

	limits in order to minimise risk.							
Certificate of Deposits issued by banks and building Societies	A) Provides additional counterparties, as many banks do not want to take fixed term cash deposits. B) Credit risk could change but if adverse there is an option to sell onto a secondary market. The Commissioner has fully considered this investment category and set appropriate investment and maturity limits in order to minimise risk.	No	Yes	Secure Varied minimum Credit rating *Minimum: Fitch Long term A- Short term F1*	No	In House	20%	6 months (but set on an individual counterparty basis)

Maximum Maturity Periods and Amounts

Organisation	Criteria	Max Amount*	Max Period
High Rated (Specified Investments – High rated and up to 364 days see Appendix 4)	Minimum Fitch rating of F1 short term and AA- long term. Consideration to be given to Moody's minimum rating of P1 short term backed by Aa3 long term and S&P minimum rating of A1 short term and AA- long term.	£20m	3 years
Foreign Banks	Must meet the minimum high rated criteria above and have a minimum sovereign rating of AA+	£20m country limit	364 days
Non-High Rated	Minimum Fitch rating of F1 short term and A- long term. Consideration to be given to Moody's minimum rating of P1 short term backed by A3 long term and S&P minimum rating of A1 short term and A- long term.	£5m	6 months
UK Local Authorities	(i.e. local authorities as defined under Section 23 of the 2003 Act)Each investment is considered on an individual basis	£10m	3 years
Money Market Funds	AAA long-term rating backed up with lowest volatility rating (MR1+) with assets >£1bn	£7.5m	Overnight

* Restricted to a maximum of either 25%only if Government backed otherwise the limit will be 20% of total investments depending on the counterparty.

Approved countries for investments — Appendix 8

This list is based on those countries which have sovereign ratings of AA+ or higher at 05/02/2016.

AAA

- Australia
- Canada
- Denmark
- Finland
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland
- U.S.A

AA+

- U.K.