WARWICK DISTRICT COUNCIL	**Executive – 8th February 2017**	**Agenda Item No.** **7**

Title:	Treasury Management Strategy Plan for 2017/2018
For further information about this report please contact	Roger Wyton 01926 456801 roger.wyton@warwickdc.gov.uk Karen Allison 01926 456334 karen.allison@warwickdc.gov.uk
Wards of the District directly affected	All
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No
Date and meeting when issue was last considered and relevant minute number	N/A
Background Papers	Treasury Management in the Public Services – A Code of Practice and associated guidance notes– CIPFA The Prudential Code for Capital Finance in Local Authorities - CIPFA Treasury Management file L1/9 Treasury Management information via External Advisors, Brokers etc.

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	Yes
Included within the Forward Plan? (If yes include reference number)	Yes - 810
Equality & Sustainability Impact Assessment Undertaken	No – not relevant

Officer/Councillor Approval		
Officer Approval	**Date**	**Name**
Chief Executive/Deputy Chief Executive	10/1/2017	Andy Jones
Head of Service	11/1/2017	Mike Snow
CMT	17/1/2017	N/A
Section 151 Officer	11/1/2017	Mike Snow
Monitoring Officer	10/1/2017	N/A

Finance	11/1/2017	Roger Wyton
Portfolio Holder(s)	17/1/2017	Cllr. Peter Whiting

Consultation & Community Engagement	
None	
Final Decision?	Yes
Suggested next steps (if not final decision please set out below) N/A	

1. SUMMARY

1.1 This report details the strategy for 2017/18 that the Council will follow in carrying out its Treasury Management activities including the Annual Investment Strategy and Minimum Revenue Provision (MRP) Policy Statement.

1.2 The report consists of a number of Appendices:-

Appendix A - Annual Treasury Management Strategy Plan 2017/18
Appendix B – 2017/18 Annual Investment Strategy Including Annex 1
Appendix C – Minimum Revenue Provision Policy Statement
Appendix D – An Explanation of Credit Rating Terms
Appendix E – Economic Background
Appendix F – Glossary of Terms

2. RECOMMENDATIONS

2.1 That the Executive notes:-

The changes to the various Treasury Management Practices as detailed in paragraph 3.2 below.

2.2 That the Executive recommends to Council:-

a) The Treasury Management Strategy for 2017/18 as outlined in paragraph 3.1 below and detailed in Appendix A,

b) The 2017/18 Annual Investment Strategy as outlined in paragraph 3.3 below and detailed in Appendix B together with Annex 1 including the following changes:-

1. That as per the table in paragraph 2.2 of Appendix B, the current counterparty limits in relation to the appropriate long term credit rating are increased to those shown in the table.

2. That as per paragraph 2.5 of Appendix B, in relation to Corporate Equity Funds the current risk categories of low, medium and high and individual fund limits of £3m, £2m and £1m respectively are replaced by low and medium risk with fund limits of £4m and £2m respectively. In each case the limit to be subject to a 10% allowance for capital growth. These changes to take immediate effect.

3. That as per paragraph 2.6 of Appendix B, the policy on the use of Financial Derivatives is approved.

c) The Minimum Revenue Provision Policy Statement as outlined in paragraph 3.4 below and contained in paragraphs 4.1 to 4.4 of Appendix C.

d) The Prudential Indicators as outlined paragraph 3.5 below and contained in paragraphs 5.1 to 5.5 of Appendix A.

3. REASONS FOR RECOMMENDATIONS

3.1 The Council is required to have an approved Treasury Management Strategy, including an Annual Investment Strategy and Minimum Revenue Provision Policy within which its Treasury Management operations can be carried out. The Council will be investing approximately £18.86 million in new capital schemes in 2017/18 and will have average investments of £75 million (2016/17 latest £72m). The Council is running out of suitable counterparties with which to invest thus requiring changes to counterparty limits in 2017/18 in order to create headroom to absorb the predicted increase in investment balances from 2017/18 onwards. The level of cash available to invest arises from the Council's reserves and provisions, the General Fund (GF) and Housing Revenue Account (HRA) balances, and accumulated capital receipts as well as working capital cashflow.

3.2 The Council's treasury management operations are also governed by various Treasury Management Practices (TMP's), the production of which is a requirement of the CIPFA code and which must be explicitly followed by officers engaged in treasury management. These have previously been reported to the Executive. There have been the following changes to various Treasury Management Practices (TMP's) and these changes are outlined below

TMP 1 Risk Management.

Paragraph 2.2 – Revision of counterparty limits to reflect the increases as per recommendation 2.2.b.1 above.

Paragraph 2.2 – Revision of Corporate Equity Fund limits and amended definition of risk as per recommendation 2.2.b.2 above.

TMP5 Organisation, Clarity and Segregation of Responsibilities and Dealing Arrangements.

Paragraph 4.1 – amended to include use of other on-line portals as well as that provided by Sungard.

Paragraph 5.1 – amended to include e mailing as a means of communicating instructions to Santander, Lloyds Banking Group and Svenska Handelsbanken investment counterparties.

3.3 This Council has regard to the Governments Guidance on Local Government Investments and CIPFA's updated Treasury Management in Public Services Code of Practice. The guidance states that an Annual Investment Strategy must be produced in advance of the year to which it relates and must be approved by the full Council. The Strategy can be amended at any time and it must be made available to the public. The Annual Investment Strategy for 2017/18 is contained within Appendix B and its Annex.

3.4 The Council has to make provision for the repayment of its outstanding long term debt and other forms of long term borrowing such as Finance Leases. Statutory guidance issued by CLG requires that a statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which it relates and this is contained in Appendix C.

3.5 The Prudential Code for Capital Finance in local authorities which was revised in 2011 introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy. The Prudential Code requires the Council to set a number of Prudential Indicators and this report does therefore incorporate within section 5 of Appendix A the indicators to which regard should be given when determining the Council's treasury management strategy for the next 3 financial years.

4. POLICY FRAMEWORK

4.1 **Policy Framework** - This report is in accordance with the Council's established Treasury Management Policies, Code of Financial Practice and provides a framework within which it will conduct its Treasury Management Operations in 2017/18.

4.2 **Fit for the Future** – The Treasury Management function enables the Council to manage its resources appropriately to balance its budget. In respect of the Fit For the Future, the Strategy greatly assists the Money strand by helping to ensure the best turn on investments and so in turn will help the Service strand by ensuring finance is available to maintain or improve services which in turn will help the People strand by maintaining employment and the appropriate support.

4.3 **Impact Assessments** – No impacts of new or significant policy changes proposed in respect of Equalities.

5. BUDGETARY FRAMEWORK

5.1 The Treasury Management Strategy has a potentially significant impact on the Council's budget through its ability to maximise its investment interest income whilst minimising the risk of the loss of the Council's funds and minimise its borrowing interest payable which is of particular importance to the HRA under the Self Financing regime and also the General Fund in respect of borrowing on projects such as leisure centre and multi-storey car parks refurbishments as well as any future capital projects. This also helps to underpin the Council's Corporate Objectives and delivery of its Fit For The Future projects. The performance of the Treasury Management function is reported half-yearly to the Finance & Audit Scrutiny Committee which is the body charged by the Council with overseeing the treasury management activities of the council. Also an annual report for the Finance & Audit Scrutiny Committee is prepared at the end of the financial year on Treasury Management and compliance with the strategy and the Treasury Management Practices are reviewed as part of the annual Treasury Management audit.

5.2 Treasury Management is an evolving process and whilst it is not easy to compare investment returns from year to year due to complications arising from economic conditions, the previous year's performance together with feedback on our current performance from the Council's involvement in Capita Asset Services' Treasury Management Benchmarking Club is reviewed to see what lessons can be learnt that would help improve the current and future years investment returns and/or the security of the investments. For instance, this may take the form of revising the Council's counterparty limits to allow for a tiered approach according to the Fitch Long Term credit rating assigned to individual counterparties.

6. RISKS

6.1 Treasury Management is essentially about the management of risk, e.g. the risk to the security of the Council's investments should a counterparty fail, liquidity risk in that there is a need to ensure that there is sufficient cash available to meet debts as and when they become due and interest rate risk in that the Council may be "locked" into low interest yielding investments at the time that interest rates are rising and therefore missing out on opportunities to maximise interest receipts. These risks are mitigated by the use of different investment vehicles, credit rating criteria and market intelligence in order to ensure the Council invests with only the best quality counterparties, good cash flow forecasting both short and long term and the use of interest rate forecasts published by the Council's treasury consultants.

6.2 The use of different investment vehicles also has its risks, for instance the introduction of Corporate Bonds in 2015/16 and in 2016/17 Corporate Equity Funds has potentially increased capital risk. This is through potential capital loss due to market price fluctuations, for instance if investments have to be withdrawn early. This is mitigated by good cash flow management ensuring that investments are available for the necessary length of time to ensure that there is no negative impact on the capital value of the fund. In addition, in the cases of Equity and Bond funds mitigation is achieved by having a spread of funds with differing risk appetites rather than concentrating all investments in one fund. The introduction of a "stop loss" limit in the case of Bond/Equity Funds whereby if the value in the fund(s) goes below a defined limit, the holdings in that fund will be sold thus limiting further losses will also reduce risk as will the use of a "volatility" reserve as a certain proportion of the annual return on the fund will be credited to the reserve and then when required released to revenue to either cover or at least mitigate the impact of any deficits. The risk of capital loss is not new to the Council, some years ago the Council had a cash fund managed by Invesco which incurred capital losses on the Gilt investments within the portfolio.

6.3 The risk involved in not adopting the recommendations is outlined in paragraph 7.2.

6.4 By engaging Treasury Management Consultants, the Council is able to mitigate the risks described in paragraphs 6.1 and 6.2. These Consultants provide regular briefings, alerts and advice in respect of the Council's portfolio. The contract also includes training both in-house and by way of seminars so officers responsible for the Council's Treasury Management Function are fully competent. Adequate cover (fully trained) is provided within the Finance Department should there be a risk of staff shortages and all involved in the Treasury function have access to comprehensive procedure notes.

7. ALTERNATIVE OPTIONS CONSIDERED

7.1 The approval of an annual Treasury Management Strategy is a requirement of the CIPFA Treasury Management in the Public Services Code of Practice, the latest version of which was adopted by the Council in 2011/12.

7.2 An alternative to the strategy being proposed for 2017/18 would be to not alter the current counterparty limits but this would risk the Council running out of acceptably credit rated counterparties and possibly having to lower its minimum credit ratings below that which it feels comfortable with.

APPENDIX A ANNUAL TREASURY MANAGEMENT STRATEGY PLAN 2017/18

1. GENERAL

1.1 This part of the report outlines the strategy that the Council will follow during 2017/18. Its production and submission to the Council is a requirement of the CIPFA Code of Practice on Treasury Management in the Public Services.

1.2 The suggested strategy for 2017/18 in respect of the treasury management function is based upon the officer's view on interest rates supplemented with forecasts provided by Capita Asset Services – Treasury Solutions who are the Council's treasury advisers.

1.3 It is also a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from a) increases in interest charges caused by increased borrowing to finance additional capital expenditure b) any increases in running costs from new capital projects and c) the loss of interest on balances or reserves arising from their use in financing the capital expenditure are limited to a level which is affordable within the projected income of the council for the foreseeable future. This is covered by the Prudential Indicator calculating the Incremental Impact on the Council Tax or Housing Rent in paragraph 5.3 below.

1.4 A Glossary of Terms is included as Appendix F in order to aid Member's understanding of technical terms used in the field of Treasury Management.

2 INTEREST RATE FORECASTS FOR 2017/18

2.1 The ability to forecast the movement of interest rates is fundamental to successful investment and borrowing strategies. The Council employs Capita Asset Services – Treasury Solutions to provide interest rate forecasts and their latest view on both short and long term rates is shown in 2.2 overleaf. Their view on Bank Rate has been used to formulate the investment interest estimates for 2017/18 and future years and the PWLB rates are of particular interest in respect of the £136.157m PWLB debt taken out in late 2011/12 to finance the HRA Self Financing debt settlement as they will form the basis for any debt restructuring decisions relating to this debt that may be taken during 2017/18 although none are currently planned. The PWLB rates are also germane to any take up of the £13.843m borrowing headroom that the HRA has under the Self Financing regime and also to the £10.196m relating to the Leisure Centres refurbishment project recently approved by the Council. It is currently anticipated that most, if not all of the borrowing for the Leisure Centres will be taken in early April 2017.

2.2 The PWLB forecasts below, provided by Capita Asset Services, are based on the PWLB Certainty Rate.

Quarter	Bank Rate	5 yr PWLB Rate	10 yr PWLB Rate	25 yr PWLB Rate	50 yr PWLB Rate
Dec 2016	0.25%	1.60%	2.30%	2.90%	2.70%
Mar 2017	0.25%	1.60%	2.30%	2.90%	2.70%
Jun 2017	0.25%	1.60%	2.30%	2.90%	2.70%
Sep 2017	0.25%	1.60%	2.30%	2.90%	2.70%
Dec 2017	0.25%	1.60%	2.30%	3.00%	2.80%
Mar 2018	0.25%	1.70%	2.30%	3.00%	2.80%
Jun 2018	0.25%	1.70%	2.40%	3.00%	2.80%
Sep 2018	0.25%	1.70%	2.40%	3.10%	2.90%
Dec 2018	0.25%	1.80%	2.40%	3.10%	2.90%
Mar 2019	0.25%	1.80%	2.50%	3.20%	3.00%
Jun 2019	0.50%	1.90%	2.50%	3.20%	3.00%
Sep 2019	0.50%	1.90%	2.60%	3.30%	3.10%
Dec 2019	0.75%	2.00%	2.60%	3.30%	3.10%
Mar 2020	0.75%	2.00%	2.70%	3.40%	3.20%

2.3 The Monetary Policy Committee (MPC) utilises Bank Rate as one of its tools to control inflation in the economy and meet its target rate of 2% Consumer Prices Inflation (CPI).

2.4 Recent changes in market sentiment and outlook has led to Capita Asset Services revising their view of when Bank Rate might start to rise with the first rise now being predicted for the June quarter of 2019.The background to these changes is reflected in Appendix E which contains Capita's view of the economic background.

CAPITAL BORROWING AND CAPITAL PROGRAMME FINANCING STRATEGY

3.1 The Council is able to finance its capital programmes in the following ways:-

a) By the use of Prudential Borrowing. Currently it is anticipated that there will be a need to use £8.996m of the external borrowing referred to in paragraph 2.1 in order to part finance the Council's General Fund 2017/18 capital programme. This relates to the Leisure Centres refurbishment programme.

b) From Usable capital receipts. Currently it is not intended to utilise capital receipts in funding the 2017/18 General Fund Capital Programme. The Housing Investment Programme anticipates significant council house sales during 2017/18 resulting in £5.719m being available to part finance current and future expenditure alongside receipts in hand from previous years.

c) From revenue or reserves.

d) From external contributions and grants. With regard to the General Fund Capital Programme, it is anticipated that external contributions amounting to £2.203m will be used to part finance the 2017/18 expenditure on the Leisure Centre refurbishment programme. With regard to the Housing Investment Programme it is expected that grants amounting to £423,100 will be utilised to finance General Fund Housing Improvement Grants.

e) From Leasing or other similar means of capital finance.

3.2 With the exception of dedicated external grants and contributions, before deciding which of the above means of capital financing will be utilised to finance capital expenditure, the Council will conduct an options appraisal exercise where appropriate.

3.3 The financing of the Council's proposed 2017/18 capital programmes (at January 2017) is shown in the table below:-

Financing Method	**General Fund £**	**Housing Investment Programme £**
Prudential/Internal Borrowing	8,996,000	0
Leasing	0	0
Capital Receipts	0	1,012,400
External Contributions	2,203,000	423,100
Revenue Contributions	125,000	205.900
Reserve Contributions	904,300	4,986,600
TOTAL	**12,228,300**	**6,628,000**

4. LONG TERM AND TEMPORARY BORROWING

4.1 The Council's current long term borrowing portfolio consists of £136.157m PWLB debt. These loans were taken out to finance the HRA Self Financing settlement and the interest paid on this debt is entirely borne by the Housing Revenue Account and is provided for as part of the HRA Business Plan.
The first of these loans is scheduled to be repaid on 28th March 2053 with the

final loan being repaid on 28th March 2062.

4.2 As part of their ongoing services, Capita Asset Services will monitor the HRA debt portfolio during 2016/17 identifying, where appropriate, any opportunities for debt restructuring although these are expected to be minimal, if at all.

4.3 With regard to the long term borrowing in respect of the Leisure Centre refurbishments it can be seen from the table in 2.2 above that PWLB rates are expected to remain stable until around September 2017 when they are forecast to begin to rise slowly. Therefore in order to take advantage of the current low point in the yield curve it is intended to take out the borrowing early in April 2017. Based on the latest project spend profile, it is likely that Annuity loans of £3,678,000 and £6,518,000 for 25 and 40 years respectively equating to the expected life of the assets financed will be taken. This will result in interest and Minimum Revenue Provision charges of c£483k being charged to the General Fund. £8.996m and £0.152m of the capital expenditure financed by this borrowing will be incurred in 2017/18 and 2018/19 respectively with the balance of the borrowing going to replace the internal borrowing incurred in financing capital expenditure incurred in 2015/16 and 2016/17. In this way, the cost of carry i.e. the difference between the annual borrowing costs and the amount received by investing the loan capital temporarily until utilised will be minimised.

4.4 Should the Council identify any further long term borrowing needs during 2017/18, if deemed to be advantageous due to the expected path of interest rates, the Council may borrow in advance of need subject to prior appraisal of the risk and the borrowing must not take place in excess of 18 months before the anticipated need.

4.5 The major source of long term borrowing for local authorities is the Public Works Loans Board (PWLB) which is part of HM Treasury. However, the Local Government Association is in the process of creating an alternative called the Municipal Bond Agency. It is possible that this agency will be offering loans to local authorities during 2017/18 and it is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). Although unlikely to be available for when the Leisure Centre borrowing is taken, should this Council consider any further long term borrowing in 2017/18 or future years then it will make use of this new source of borrowing as and when appropriate.

4.6 The Council will continue to engage in short term borrowing (up to 364 days) when necessary in order to finance temporary cash deficits, however by managing the Council's cash flow effectively these will be kept to a minimum. In each case, wherever possible, the loan will be taken out for periods of less than 7 days in order to minimise the interest payable. To date in 2016/17 the Council has not incurred any short term borrowing and is not expected to do so in 2017/18 either.

5. TREASURY LIMITS AND PRUDENTIAL INDICATORS FOR 2017/18 TO 2019/20

5.1 It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Authorised Limit". The Council must have regard to the Prudential Code when setting its Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax / rent levels is acceptable. Whilst termed an Authorised Limit, the capital plans to be considered for inclusion incorporate those planned to be financed by both external borrowing and other forms of liability, such as credit arrangements e.g. finance leases. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. The limits shown in the table in paragraph 5.2 include the impact of the HRA Self Financing debt settlement which took place on the 28th March 2012. It also includes the HRA "Headroom" which is the amount that the HRA can borrow between the debt settlement and the Debt Cap set under the Self Financing regime and also the £10.196m borrowing for the Leisure Centre refurbishment project. On top of this an allowance has been made for potential new capital projects such as car parks refurbishments etc.

5.2 The Authorised Limits to be recommended to Council by the Executive were included in the Budget report presented to the Executive on 8th February and need to be ratified by the Council at its meeting on 22nd February. They are also displayed in the table below:-

Authorised Limit	**2016/17 (For Comparison) £,000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
Debt	22,050	56,050	66,050	66,050
Add HRA Settlement	136,157	136,157	136,157	136,157
HRA Head Room	13,843	13,843	13,843	13,843
Other Long Term Liabilities	2,079	2,063	2,047	2,012
Total	**174,129**	**208,113**	**218,097**	**218,062**

5.3 The Prudential Indicators required by the code are explained in more detail in the report on the budget and those relevant to an integrated treasury management strategy are reproduced overleaf:-

a) **Operational Boundary for External Debt**

Operational Boundary	2016/17 (For Comparison) £,000	2017/18 Estimate £,000	2018/19 Estimate £,000	2019/20 Estimate £,000
Debt	13,050	13,050	13,050	13,050
Add HRA Settlement	136,157	136,157	136,157	136,157
HRA Head Room	13,843	13,843	13,843	13,843
Other Long Term Liabilities	1,079	1,063	1,047	1,030
Total	164,129	164,113	164,097	164,080

The Council is required to set an Operational Boundary for external debt which itself forms part of the Authorised Limit. The Operational Boundary is effectively the day to day working limit for cash flow purposes.

b) That the Council has adopted the revised CIPFA Treasury Management Code of Practice which it did in February 2011.

c) **Capital Financing Requirement**

Year	General Fund (inc. GF HIP element)	HRA	Overall
2016/17 (for comparison)	£2,398,137	£135,786,796	£138,184,933
2017/18	£11,248,319	£135,786,796	£147,035,115
2018/19	£11,232,079	£135,786,796	£147,018,875
2019/20	£11,040,460	£135,786,796	£146,827,256

The Capital Financing Requirement (CFR) as shown in the table above is a measure of the Council's underlying need to borrow in order to meet past capital expenditure. It will be noted that the 2017/18 General Fund CFR has increased when compared to the 2016/17 figure and also the 2015/16 actual which was -£1,215,451. This is due to the borrowing required to finance the Leisure Options project capital expenditure in the current General Fund capital programme. The CFR is reduced by any provision for the repayment of debt each year. In the case of the General Fund CFR this is the principal element of the PWLB Annuity loans expected to finance the Leisure Centre borrowing and the principal element of the Dog Van and Colour Copier leases. In the case of the HRA debt redemption is not scheduled to start until year 41 (2052/53) of the current Business Plan.

d) **Incremental Impact on Council Tax / Housing Rents**

Year	Council Tax	Housing Rent
2016/17 (for comparison)	£1.47	£0.33
2017/18	£7.40	£0.28
2018/19	-£3.59	£0.29
2019/20	-£2.45	£0.47

The significant increase in the Council tax in 2017/18 is due to the debt servicing costs in relation to the Leisure Centre borrowing. This is negated in future years as savings arising from the project materialise.

e) As a result of HRA Self Financing, the Council is also limited to a maximum HRA CFR. This limit is currently:-

HRA Debt Limit	2016/17 (for comparison)	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Total	150.00	150.00	150.00	150.00

5.4 In addition certain indicators that used to be part of the Prudential Code are now part of the Treasury Management Code of Practice and are shown overleaf :-

Upper limits to fixed interest rate and variable interest rate exposures on borrowing

Year	Upper Limit - Fixed Rate	Upper Limit - Variable Rate
2017/18	100%	30%
2018/19	100%	30%
2019/20	100%	30%

Upper and Lower Limits respectively for the Maturity Structure of Fixed Interest Rate Borrowing

Period	Upper	Lower
Under 12 months	4%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	20%	0%
5 years and within 10 years	20%	0%
10 years and above	96%	0%

Upper and Lower Limits respectively for the Maturity Structure of Variable Interest Rate Borrowing

Period	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%

5.5 **Principal sums invested for periods longer than 364 days**

The total maximum sum that can be invested for more than 364 days is 70% of the core investment portfolio subject to a maximum of £20 million at any one time. However, where investments which originally were for periods of more than 364 days have 364 days or less to maturity at the 1st April each year they shall be classed from that date as short term i.e. less than 364 day investments and will not count against the 70% or £20 million limit.

6. BEST VALUE

6.1 The Council participates in Capita Asset Services' investment risk management benchmarking service in order to provide benchmarks against which the in house function could monitor its performance. The Council is part of a local group comprising both District and County Councils and our investment rate of return is benchmarked on a weighted average basis against the Capita Asset Services Model Portfolio and the returns experienced by the other club members. In 2017/18, other than for investments in Corporate Bond or Equity Funds the Council will seek to achieve a weighted average rate of return in line with the Capita Asset Services Model Portfolio which is based upon the best possible return whilst providing the maximum security for the capital invested.

6.2 The internal treasury function will also seek to achieve an average rate of return on its Money Market investments of 0.0625% over the LIBID (London Inter Bank Bid Rate) average for comparable investment periods (e.g. up to 7 day, 1 to 3 months, 3 to 6 months and over 6 months).

6.3 Should the Council employ external cash fund investment agents during 2017/18 suitable performance indicators will be agreed with the agents similar to that which operated under the previous Invesco agreement e.g. the fund will be required to outperform the Financial Times 7 day LIBID rate compounded weekly with a target return of 110% of the benchmark over a 3 year rolling period. Suitable benchmarks will also be agreed with Corporate Bond/Equity Fund managers in respect of the funds opened with them.

6.4 The Council's performance is reported half-yearly to the Finance and Audit Scrutiny Committee.

7. EXTERNAL TREASURY MANAGEMENT ADVISERS

7.1 In order to access specialist skills and resources such as credit rating information, the Council employs Capita Asset Services – Treasury Solutions as its Treasury Management advisers. Following a procurement exercise they were re-appointed for another three years with effect from 5th January 2015 with an option to extend the contract for a further two years.

8. BANKING SERVICES

8.1 The Council currently employs HSBC Bank to provide its banking services and. the current contract runs for 5 years from 1st March 2015 with the option to extend the contract for a further 5 years.

9. TRAINING

9.1 The CIPFA Code requires that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Following the 2015 Council elections, our treasury consultants delivered in house training on 29th October 2015 to a number of Members. Further training will be provided as and when required.

9.2 Those officers currently involved in treasury management have received training from the Council's treasury consultants and this has been and will be kept up to date by regular attendance at seminars held by our consultants and also through other sources such as CIPFA publications and market intelligence.

10. OTHER

10.1 Although though not currently included in the Council's General Fund capital programme there are potential schemes in future years which may require the Council to significantly increase its external long term borrowing for instance the refurbishing of certain multi-storey car parks. This will have a significant effect on both the Council's treasury management operations and also its revenue budgets and the Treasury Management function will advise on the implications accordingly.

APPENDIX B 2017/18 ANNUAL INVESTMENT STRATEGY

1. BACKGROUND

1.1 This Council has regard to the Governments Guidance on Local Government Investments and CIPFA's updated Treasury Management in Public Services Code of Practice. Section 15(1) of the 2003 Local Government Act requires councils to have regard to such guidance as the Secretary of State may issue. Guidance was issued in 2004 and has subsequently been updated (April 2010) with the last major change being that Local Authorities who invest in Corporate Bonds no longer need to account for these as capital transactions i.e. capital expenditure. The general policy objective is that local authorities should invest prudently the temporarily surplus funds held on behalf of their communities. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. The guidance states that an Annual Investment Strategy must be produced in advance of the year to which it relates and must be approved by the full Council. The Strategy can be amended at any time and it must be made available to the public.

2. INVESTMENT VEHICLES AND CREDITWORTHINESS POLICY

2.1 In line with the guidance, this Annual Investment Strategy states which investments the Council may use for the prudent management of its treasury balances during the financial year under the headings of Specified and Non Specified Investments. These are listed in paragraph 2.8 and detailed in Annex 1.

2.2 Specified investments are defined as those with a high credit rating. Currently for deposits with Banks this is a Fitch (or Moody's and Standard & Poor's equivalents) sovereign rating at least equal to that of the United Kingdom at the point at which the investment was taken out, at least F1 short term and A long term. However, mindful of the increasing balances available for investment and the need to maximise investment interest in the current low interest rate environment without significantly weakening the security of the investments a restructuring of both long term counterparty ratings and limits relating to both Specified and Non Specified Instruments is proposed. The changes are reflected in Appendix B Annex 1 and summarised in the table overleaf:-

Counterparty Type	Investment Vehicles	long term rating	Current Limit ex. Repo addition	New limit ex. Repo addition
Private banks	**Fixed term deposits Certs of Deposits FRN's (category 1) Corp Bonds (category 1) Covered Bonds (category 1)**	**A A+ AA- and above**	**£3m £5m £5m**	**£4m £6m £7m**
Other Private Sector Financial Institutions	**FRN's (category 1) Corp Bonds (category 1) Covered Bonds (category 1)**	**A A+ AA- and above**	**£3m £5m £5m**	**£4m £6m £7m**
Corporates	**FRN's (category 3) Corp Bonds (category 3) Covered Bonds (category 3)**	**A A+ AA- and above**	**£3m £3m £3m**	**£4m £5m £6m**

2.3 Over the period 2017/18 to 2020/21 the average balances available to invest are currently predicted to rise from £75m to £104m mainly as a result of surpluses arising from the Housing Revenue Account under the Self Financing Regime and increasing capital receipts arising from Right to Buy council house sales. In order to be able to invest these increased balances as securely as possible whilst obtaining a reasonable rate of return will require the Council to add new institutions to its investment counterparties list, increase the limits for current counterparties or a combination of both. The changes recommended in the table above should go some way towards ameliorating this issue. A forthcoming report on Housing Futures will consider the potential use of the forecast increased Housing balances.

2.4 With the objective of meeting the Council's previously stated wish to achieve an additional £50,000 per annum investment income, at the time of writing this report the Council is in the process of appointing Corporate Equity Fund managers with the aid of its Treasury Advisers. It is anticipated that the successful managers will be appointed during the latter part of February with the funds being open for business by the new financial year. Initial investments will be £4m into an UK Equity Income fund and £2m into an UK Capital Growth fund with the objectives of the Equity Income fund providing annual investment income through dividend distributions with the Capital Growth fund being allowed to provide long term (up to 5 years) income through increased capital value. As with all investments of this nature there is potential for the value of the Capital Growth fund to go down as well as up and it is intended to establish a "Volatility" reserve whereby a certain amount of the annual interest received from the Equity Income fund will be diverted to this reserve in order to obviate the impact on the General Fund of any capital losses. Depending on how these initial investments perform it may be possible to invest more in them or open up additional funds which will further enhance the Council's investment income.

2.5 The current Annual Investment Strategy has Corporate Equity Funds divided into three categories of risk based on the risk and rewards profile within an individual funds Key Investor Information Document or KIID. These categories are low, medium and high with individual counterparty limits of £3m, £2m and £1m respectively. Research has shown that this arbitrary interpretation of risk is not appropriate and therefore it is proposed to alter the risk definitions to low and medium and the individual fund limits to £4m and £2m respectively although it may be necessary to revise these limits in the light of initial performance particularly for future years given the predicted increase in balances. Low risk will be defined as investments into UK Equity Income funds as these funds typically invest in well established institutions and companies which are well run and which pay regular dividends. Medium risk will be defined as investments into UK Capital Growth funds. Due to the long term nature of these funds, investments within them are exposed to more risk such as duration i.e. the longer the investment runs for the more risk there is that the value of the investment will go down rather than up, hence the categorisation of these funds as medium.

2.6 Some Corporate Equity Funds use embedded financial derivatives (interest rate swaps, forward deals etc.) in order to enhance the performance of the fund and in such circumstances the CIPFA Treasury Management code of practice requires authorities to clearly detail their policy on the use of derivatives in the Annual Investment Strategy. There are two forms of financial derivatives, standalone and embedded and the council will only use standalone financial derivatives such as swaps, forwards, futures and options where they can clearly be demonstrated to reduce the overall level of financial risks that the Council is exposed to. Embedded derivatives such as those found within Corporate Equity Funds will not be subject to this policy although the risks they present will be managed in line with the overall treasury risk management strategy.

2.7 In addition to credit ratings themselves, the Council will also have regard to any ratings watch notices issued by the 3 agencies as well as articles in the Financial press and market data. In addition to credit ratings the Council will also use Credit Default Swap data as supplied by Capita Asset Services – Treasury Solutions to determine the suitability of investing with counterparties. Credit Default Swaps (CDS) are a form of "insurance premium" against defaulting taken out by investors when making investments and if the Market perceives problems with the counterparty then the margin on the CDS will widen (i.e. the insurance premium will increase) thus providing warnings for future investors with that counterparty that it might have problems repaying their investment. The Council will monitor the CDS's on the counterparties within its lending list and if there are significant movements on a counterparty such as it moves out of a pre-determined range which will be determined with the aid of the Council's Treasury Consultants then that counterparty will be removed from the list until such time as it moves back within range.

2.8 The types of investment that the council can use are listed below and described in more detail in Annex 1. These are split under the headings of specified and non-specified in accordance with statutory guidance.

Specified Instruments (maximum period 364 Days)

Deposits with banks and building societies
Deposits with UK Government, Nationalised Industries, Public Corporations, UK Housing Associations and UK Local Authorities
UK Government Gilts with less than one year to maturity
Debt Management Agency Deposit Facility (DMADF)
Constant Net Asset Value Money Market Funds (AAA rated)
Variable Net Asset Value Money Market Funds (AAAf rated)
Certificates of deposits issued by banks and building societies
Corporate Bonds issued by private sector financial institutions
Corporate Bonds issued by financial institutions partly or wholly owned by the UK Government
Corporate Bonds issued by corporates
Covered Bonds issued by private sector financial institutions
Covered Bonds issued by financial institutions partly or wholly owned by the UK Government

Covered Bonds issued by corporates
Supranational Bonds issued by Supranational Institutions or Multi Lateral Development Banks
Floating Rate Notes issued by private sector financial institutions
Floating Rate Notes issued by financial institutions partly or wholly owned by the UK Government
Floating Rate Notes issued by corporates
Eligible Bank Bills
Sterling Securities guaranteed by HM Government
Repo's

Non Specified Investments

Deposits with unrated building societies
Deposits with banks and building societies greater than 364 days
Deposits with UK Housing Associations and UK Local Authorities greater than 364 days
Certificates of deposits issued by banks and building societies greater than 364 days
Corporate Bonds issued by private sector financial institutions greater than 364 days
Corporate Bonds issued by financial institutions partly or wholly owned by the UK Government greater than 364 days
Corporate Bonds issued by corporates greater than 364 days
Covered Bonds issued by private sector financial institutions greater than 364 days
Covered Bonds issued by financial institutions partly or wholly owned by the UK Government greater than 364 days
Covered Bonds issued by corporates greater than 364 days
Corporate Bond Funds
Regulated Property Funds including Real Estate Investment Trusts
CCLA Property Fund
Day to Day balances where Council's bankers do not meet the minimum bank credit rating criteria
UK Government Gilts with over 364 days to maturity
Supranational Bonds issued by Supranational Institutions or Multi Lateral Development with over 364 days to maturity
Corporate Equity Funds

2.9 It is necessary to outline the reasons why the Council would use non specified investments and also the risks involved. The use of unrated building societies alongside Business Reserve and Call Accounts and Money Market Funds forms a useful tool for investing relatively small amounts of money for short periods of time (up to 3 months) and obtaining a decent return on the investment. There is of course a risk that the Building Society may fail during the maximum 3 month duration of an investment but this is not considered likely. As an additional safeguard, the Council will only invest in Category C i.e. unrated Building Societies with an asset value of £500m and over. In addition, investments in category C building societies are restricted to a group limit of £8m.With regard to deposits for more than one year, the advantage from a treasury management point of view is that there is a known rate of return over the period that the monies are invested which aids forward planning. There is however the increased risk due to the longer time span that a) the institution fails or b) interest rates rise in the meantime. The current limit for investments longer than 364 days is 70% of the core investment portfolio subject to a maximum of £20 million at any one time with a maximum of £15m invested in Corporate Bond/Equity/Property Funds and a maximum duration of 10 years for Property, Corporate Bond and Corporate Equity Funds, 5 years for investments with other Local Authorities and 2 years for all other counterparties. It is not proposed to alter these parameters for 2017/18.

2.10 No investments for more than 364 days excluding any forward deal periods will be made without the advice of our Treasury Consultants on the likely movement of interest rates over the period of the proposed investment and any investments over 364 days with building societies will be limited to £1m per counterparty**.** In the case of Property, Corporate Bond and Corporate Equity Funds, decisions to invest will be taken in conjunction with our Treasury Consultants and the respective Fund Managers.

2.11 As a means of further diversifying risk whilst obtaining a reasonable return for cash flow derived investments, the Council uses the SunGard Money Market Funds Portal which will enable it to open further Money Market Funds as necessary and to be able to see on a daily basis before deciding with whom to invest, which funds are offering the best rates.

3. INVESTMENT OBJECTIVES

3.1 All investments will be in sterling. The Council's investment priorities are the security and liquidity of its investments. The Council's objective will be to maximise the return whilst safeguarding as much as possible the capital sum and avoiding cash flow problems. The Council will not engage in borrowing for purely investment purposes.

4. SECURITY OF CAPITAL

4.1 The Council relies on credit ratings published by the three main Credit Rating agencies , Fitch Ratings, Moody's Investor Services and Standard & Poor's which are supplied to it by its Treasury Advisers. These ratings are used to establish the credit quality of counterparties and investment schemes. These institutions also issue regular ratings watch bulletins and where these are negative and affect one of our counterparties this will be taken into account when deciding whether or not to place future investments with them. The Council has also determined the minimum long term (365 days or more), short term (364 days or less) and other credit ratings it deems to be high for each category of investment and these are as shown in paragraph 2.2 above.

4.2 Individual credit ratings will be revised as and when changes are notified to the Council by its Treasury Advisers. If a counterparty or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria then the counterparty/investment vehicle will no longer be used with immediate effect. This also applies to investments placed by fund managers. Similarly if a counterparty is upgraded so that it meets the

Council's minimum credit rating requirements then it will be added to the Council's counterparty list.

4.3 The Council will also use the Credit Default Swap (CDS) information supplied by its Treasury Consultants to determine levels of investments with its counterparties once they have been selected using the criteria set out in 2.2 above. Counterparties with an in range CDS (as determined by our consultants) will be invested in as per the limits defined for that particular category of counterparty. Those counterparties with either a monitoring or an out of range status will not be invested in until their CDS returns to within range.

4.4 The Council's revised Investment Strategy will include the use of Corporate Equity Funds and risk definitions in the fund KIID (Key Investment Information Document) documents have been used to select suitable funds. This approach and how the risk score is used to deal with security of capital is covered in paragraph 2.5 above.

5. INVESTMENT BALANCES / LIQUIDITY OF INVESTMENTS

5.1 Based on its cash flow forecasts, the Council anticipates that its investments in 2017/18 on average will be in the region of £75m of which £44m will be "core" investments i.e. made up of reserves and balances which are not required in the short term**.**

5.2 The maximum percentage of its core investments that the Council will hold in long term investments (365 days or over) is 70%. It follows therefore that the minimum percentage of its overall investments that the Council will hold in short term investments (364 days or less) is 30%. Having regard to the Council's likely cash flows and levels of funds available for investment the amount available for long term investment will be a maximum of 70% of the core investment portfolio subject to a total of £20 million at any one time in line with the proposed Prudential Indicator covering this issue. These limits will apply jointly to the in house team and any fund managers so that the overall ceilings of 70% and £20 million are not breached.

6. INVESTMENT STRATEGY

6.1 The Council will continue to make use of MoneyMarket Funds (MMF's), Call bank accounts and the Money Markets to invest cash flow driven money to known dates where large debts such as precepts, NNDR etc. have to be paid out. Based on the cash flow experienced to date in 2016/17 it is unlikely that this will result in the average length of a cash flow investment being more than 3 months in 2017/18 and probably considerably less. Core investments (i.e. investments not needed for payment of debts) will continue to be invested either in our Corporate Equity Funds or in the best part of the market based on the advice issued by our Treasury Advisers.

6.2 The 2017/18 interest rate outlook is for Bank Rate to remain at 0.25% all year. Based on current investment policies and interest rate projections, it is currently estimated that the overall portfolio will achieve a 0.57% return for

2017/18. The income from the Corporate Equity Funds has been conservatively set at £50,000 which hopefully will be exceeded.

7. EXTERNAL FUND MANAGERS

7.1 The performance of our Corporate Equity Fund managers will be kept under review using the Council's Treasury Consultants. Should it be felt appropriate to do so then the Council may engage further fund managers in order to manage its investments in such vehicles as Cash Management, Corporate Bond and additional Corporate Equity Funds. The appointment process will be subject to the Council's procurement rules and handled in conjunction with our Treasury Consultants in order to ensure that the Council secures best value.

8. END OF YEAR INVESTMENT REPORT

8.1 In accordance with the requirements of the Treasury Management Code of Practice, the Treasury Management function reports on its in year activities to the Finance & Audit Scrutiny Committee twice a year i.e. at mid-year and at the end of the year.

APPENDIX C

MINIMUM REVENUE PROVISION POLICY STATEMENT

1. BACKGROUND

1.1 Capital expenditure can be financed in a number of ways, not least of which is through borrowing and credit arrangements such as finance leases. The use of these 2 methods involves the Council in setting aside resources each year in order to eventually pay off the liability for example a maturing PWLB loan. Until recently, this set aside was prescribed nationally through Statutory regulations and was set at 4% per annum of the General Fund Capital Financing requirement (CFR). There was no similar requirement within the Housing Revenue Account although Council's could make voluntary provision if they so wished. The statutory regulations were superseded by statutory guidance issued under Statutory Instrument 2008 no.414 which says that "A local authority shall determine for the current financial year an amount of minimum revenue provision (MRP) that it considers prudent". Where a Council's CFR at the end of the preceding year is nil or negative there is no requirement to charge MRP.

1.2 It is a requirement of the statutory guidance that a statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which it relates. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

2. THE FOUR MAIN OPTIONS

Option 1 – Regulatory Method

2.1 This option is the old statutory method of 4% of the CFR and which has to be used in order to calculate MRP on all debt still outstanding at 1/4/08 and it can also be used to calculate MRP on debt incurred under the new system but which is supported through the annual SCE (Supported Capital Expenditure) allocation from DCLG.

Option 2 – Capital Financing Requirement Method.

2.2 This is a variation of option 1 and is based upon 4% of the CFR with certain changes and is appropriate where the borrowing is not linked to a particular asset.

Option 3 – Asset Life Method.

2.3 Under this option, it is intended that MRP should be spread over the useful life of the asset financed by the borrowing or credit arrangement. In future, where borrowing is utilised to finance specific assets it is likely that the period of the loan will match the expected life of the asset and therefore, under this method the annual charge to the Council's accounts is directly related to building up the provision required to pay off the loan when it matures which under options 1 and 2 is not possible.

2.4 There are 2 methods of calculating the annual charge under this option a) equal annual instalments or b) by the annuity method where annual payments gradually increase during the life of the asset.

Option 4 – Depreciation Method.

2.5 This is a variation on option 4 using the method of depreciation attached to the asset e.g. straight line where depreciation is charged in equal instalments over the estimated life and the reducing balance method where depreciation is greater in the early years of an assets life and which is most appropriate for short lived assets e.g. vehicles. In this Council's case assets are depreciated using the straight line method and so option 4 is not materially different from option 3.

3. HRA MINIMUM REVENUE PROVISION.

3.1 Under the Self Financing regime, the HRA Business Plan has to provide resources for the repayment of the £136.157m borrowed from the PWLB on the 28th March 2012. Repayment of this debt is currently provided for commencing in year 41 (2052/53) and continuing through to year 50 year of the Business Plan. Provision will also have to be made for any use made of the £13.843m "headroom" between the Self Financing debt settlement i.e. the PWLB borrowing and the "Debt Cap" imposed by the Government.

4. RECOMMENDATION FOR 2017/2018.

4.1 It is recommended that for any long term borrowing on the General Fund e.g. Leisure Centre refurbishments which is incurred in 2017/2018, the following methods of Minimum Revenue Provision be adopted:-

For borrowing which cannot be linked to a particular asset – Option 2.
For borrowing linked to a particular asset – Option 3 based on the annuity method.

4.2 For any borrowing incurred through Finance Leases, the annual principal repayments in the lease are regarded as MRP.

4.3 Although not strictly part of Minimum Revenue Provision requirements, it is also recommended that for internal borrowing (i.e. capital expenditure financed from reserves) , where appropriate, Option 3 based on the annuity method be adopted as a means of replenishing those reserves which financed the capital expenditure.

4.4 With regard to the HRA, annual MRP to be equal to any amounts set aside for debt repayment within the Business Plan which currently is nil for 2017/18.

APPENDIX D

AN EXPLANATION OF CREDIT RATING TERMS

1. Sovereign Credit Rating

1.1 Fitch assigns a long term credit rating to the country in which the financial institution being rated is domiciled. This credit rating assesses the economic health of the country including its ability to service its debt and also its capacity to support the banking system in that country should financial support be required. The assessment follows the normal long term rating scale, the highest rating being AAA with anything below BBB being non investment grade i.e. "junk bond status". The UK has a AA Fitch rating and the Council's policy is to invest only in institutions where the state in which they are domiciled has at least the same sovereign rating as the UK at the point in time when the investment was placed.

2. International Long - Term Credit Ratings

2.1 Long - term credit ratings are an attempt to assess the ongoing stability of an institutions prospective financial condition given such factors as sensitivity to fluctuations in market conditions and the capacity for maintaining profitability or absorbing losses in a difficult operating environment. Traditionally they look beyond a 12 month horizon. Investment grade ratings range from BBB to AAA.

2.2 The minimum rating that WDC will use is A which is mid range in the ratings referred to above. A ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong.

3. International Short - Term Credit Ratings

3.1 A short - term rating has a timescale of less than 12 months for most obligations and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

3.2 The minimum rating that WDC will use is F1. This indicates the strongest capacity for timely payment of financial commitments. It may have a + added to it to denote any exceptionally strong credit feature.

APPENDIX E

Capita Asset Services' View of the Economic Background

1. United Kingdom.

1.1 GDP growth rates in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.5%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

1.2 The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

1.3 The Monetary Policy Committee, (MPC), meeting of 4th August was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

1.4 The MPC meeting of 3 November left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

1.5 The latest MPC decision included a forward view that Bank Rate could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

1.6 The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

1.7 The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, consumers have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015 and were again strong in November. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, in November it fell to -8 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

1.8 Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit. Capital Economics' GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

1.9 The Chancellor has said he will do 'whatever is needed' i.e. to promote growth; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

1.10 The other key factor in forecasts for Bank Rate is inflation where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16).This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

1.11 What is clear is that consumer disposable income will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.2% in November. However, prices paid by factories for inputs rose to 13.2% though producer output prices were still lagging behind at 2.3% and core inflation was 1.4%, confirming the likely future upwards path.

1.12 Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

1.13 Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October.The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. House prices have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

2. United States of America.

2.1 The American economy had a patchy 2015 with sharp swings in the quarterly growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.2% signalled a rebound to strong growth. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed. therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

2.2 The result of the presidential election in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

2.3 Trump's election has had a profound effect on the bond market and bond yields rose sharply in the week after his election. Time will tell if this is a a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

2.4 In the first week since the US election, there was a a major shift in investor sentiment away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

3. Eurozone.

3.1 In the Eurozone, the ECB commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

3.2 EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

3.3 There are also significant specific political and other risks within the EZ: -

- Greece continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.
- Spain has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.
- The under capitalisation of Italian banks poses a major risk. Some German banks are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their

vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.

- 4 December Italian constitutional referendum on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.
- Dutch general election 15.3.17; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.
- French presidential election**;** first round 13 April; second round 7 May 2017.
- French National Assembly election June 2017.
- German Federal election August – 22 October 2017. This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.
- The core EU, (note, not just the Eurozone currency area), principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

3.4 Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

4. Asia.

4.1 Economic growth in China has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

4.2 Economic growth in Japan is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

5. Emerging countries.

5.1 There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that $340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

5.2 Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.

APPENDIX F

GLOSSARY OF TERMS

Basis Point (BP)	1/100th of 1%, i.e. 0.01%
Bank Rate	Minimum lending rate of a bank or financial institution in the UK.
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit (CD)	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.

Corporate Equity Fund	A managed fund that invests in stocks, also called equities securities. The fund's assets are typically mainly in stock, with some amounts of cash and bonds. The objective is long term growth through capital gains as well as dividends on the stocks held within the fund.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)
CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement.
CIPFA	Chartered Institute of Public Finance and Accountancy.
CLG	Department for Communities and Local Government.
Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.
ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is the keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.

Forward Deposits	Same as forward dealing (above).
Fiscal Policy	The government policy on taxation and welfare payments.
GDP	Gross Domestic Product.
Gilt	Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short-term instruments. It is very similar to a unit trust.
Monetary Policy Committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the committee. Their secondary target is to support the government in maintaining high and stable levels of growth and employment.
Other Bond Funds	Pooled funds investing in a wide range of bonds.
PWLB	Public Works Loan Board.
QE	Quantitative Easing.
Repo's	Re-purchase agreement (Repo) to sell securities and buy them back at a later date at a specified price. The difference between the sale price and the re-purchase price represents the interest on the transaction.
Retail Price Index	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.
Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states, but excluding UK government bonds.

Supranational Bonds	Bonds issued by supranational bodies, e.g. European Investment Bank. The bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts.
Treasury Bill	Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.