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CABINET

21 November 2017

MID-YEAR REPORT ON TREASURY MANAGEMENT AND PRUDENTIAL INDICATORS 2017/18

Report of the Director for Resources

Strategic Aim:	Sound Financial Planning	
Key Decision: No	Forward Plan Reference: FP/160617	
Exempt Information	No	
Cabinet Member(s) Responsible:	Mr Tony Mathias, Leader and Portfolio Holder for Finance and Places (Highways, Transport and Market Towns)	
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Ward Councillors	N/A	

DECISION RECOMMENDATIONS
That Cabinet notes the contents of the report.

1 PURPOSE OF THE REPORT

1.1 Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid-year treasury review report in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously.

1.2 This report meets the requirement above and incorporates the needs of the Prudential Code to ensure adequate monitoring of capital expenditure plans and the Council's prudential indicators (PIs). The treasury strategy and PIs were contained in report 41/2017 which was approved by Council on 14 February 2017.

1.3 The underlying purpose of this report also supports the objective in the revised CIPFA Code of Practice on Treasury Management and the

Department of Communities and Local Government (DCLG) Investment Guidance which Members receive reports on and adequately scrutinise the treasury management service.

2 BACKGROUND AND MAIN CONSIDERATIONS

2.1 The Council's mid-year treasury report is included in Appendix A and includes information on the performance of the treasury management service. The key points to note for the six months to 30 September 2017 are:

- The Council has only invested with approved institutions;
- The Councils has made a return on investment of 0.66% compared to the LIBOR rate of 0.48% through investing larger amounts for longer periods;
- The Council has not undertaken any external borrowing in the six months to 30 September 2017. The Council is still below its authorised limit for borrowing of £28m; and
- No external debt was repaid early as there was not a financial business case to do so. The total premium (i.e. the charge for repaying early) for the Council's debt portfolio was £16.68m as at 30th September 2017.

3 CONSULTATION

3.1 No formal consultation is required.

4 ALTERNATIVE OPTIONS

4.1 This report is for noting, there are no alternative options.

5 FINANCIAL IMPLICATIONS

5.1 There are no financial implications arising from this report.

6 LEGAL AND GOVERNANCE CONSIDERATIONS

6.1 The report meets the requirements of both the CIPFA Code of Practice on Treasury Management, the CIPFA Prudential Code for Capital Finance in Local Authorities and the Council's Financial Procedure Rules. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

6.2 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2012/13);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act DCLG has issued Investment Guidance to structure and regulate the Council's investment activities; and
- Under Section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

6.3 The Council's Treasury Management Strategy explains how it complies with this legal framework.

7 EQUALITY IMPACT ASSESSMENT

7.1 An Equality Impact Assessment (EqIA) has not been completed because the report does not represent the introduction of a new policy or service or a change / review to an existing policy or service.

8 COMMUNITY SAFETY IMPLICATIONS

8.1 There are no community safety implications.

9 HEALTH AND WELLBEING IMPLICATIONS

9.1 There are no health and wellbeing implications.

10 CONCLUSION AND SUMMARY OF REASONS FOR THE RECOMMENDATIONS

10.1 The report summarises treasury management performance in the year and meets the requirements set out in 1.1.

11 BACKGROUND PAPERS

11.1 Statement of Accounts 2016/17

11.2 Quarter 1 Finance Management Report

11.3 Quarter 2 Finance Management Report

12 APPENDICES

12.1 Appendix A - Treasury Management Mid-Year Report

12.2 Appendix B - Capita Commentary on the six months to 30 September 2017

12.3 Appendix C - Glossary

A Large Print or Braille Version of this Report is available upon request – Contact 01572 722577.

Appendix A.

TREASURY MANAGEMENT

MID-YEAR REPORT 2017/18

1 OVERVIEW OF STRATEGY

1.1 What is Treasury Management?

1.1.1 Treasury management is the term used to describe the way a Council manages the cash it needs to meet both its day-to-day running costs and borrowing for capital expenditure. The treasury management function for a council will make the arrangements to borrow and invest money either over the short or the longer term in order to ensure that it has money available when it needs it.

1.1.2 CIPFA defines treasury management as"…the management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

1.2 What framework or rules do we need to follow?

1.2.1 In making arrangements for treasury management, a council is required to follow CIPFA's Treasury Management Code. The Code aims to help ensure that councils manage the significant risks associated with the function while also ensuring the council receives value for money.

1.2.2 The Council approved a Strategy in February 2017 (report 41/2017) which covered;

- borrowing strategy, including capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time); and
- the treasury management strategy (strategy guidelines for choosing and placing investments, the principles to be used to determine the maximum periods for which funds can be committed, what specified and non specified investments will be considered how the investments and borrowings are to be organised) including treasury indicators.

1.2.3 Councils need to prove that they are complying with the Prudential Code and this is done through a series of prudential indicators that are set locally and approved at the same time as the council sets its budget for the following year.

2 TREASURY PERFORMANCE

2.1 How much have we invested during 2017/18?

2.1.1 The Council receives lots of income from council tax, business rates and central government. The majority of council tax and business rates payments are received between April and January, with expenditure being fairly static throughout the year.

2.1.2 During the first half year investments have ranged from £26.7m to £34.0m. The table below shows the level of investments held at 30 September 2017 and the forecasted balances to the end of the Financial Year.

	Investments 31-Mar-17 £000	Investments 30-Sep-17 £000	Forecast Investments 31-Mar-18 £000
UK Banks *(f)*	20,018	18,000	18,000
UK Building Societies *(f)*	6,000	12,000	6,000
UK Call Accounts *(v)*	691	1,014	1,000
Total Fixed Interest Rates *(f)*	**26,018**	**30,000**	**24,000**
Total Variable Interest Rates *(v)*	**691**	**1,014**	**1,000**
Total Investments	**26,709**	**31,014**	**25,000**

2.1.3 Most of the Councils investments are made at fixed interest rates over 6 -12 months. For cash flow purposes, some funds are held in instant access accounts (or accounts where funds can be accessed at short notice).

2.1.4 The revised budget position for investment income is:

	Original Estimate 2017/18 £000	Received to 30-Sep-17 £000	Revised Estimate 2017/18 £000
Investment Income	164	104	204
Other Interest Received *	16	16	16
Total	180	120	220

* The Council also receives interest from sources other than investments. A Housing Association has been recharged £12k for the principal and interest of loans that the Council has made to it, the final payment will be in 2051/52. In 2017/18 £4k was received from the sale of buses.

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2.2 Did we invest in line within approved rules?

2.2.1 Like us as individuals, the Council will invest surplus money in various ways to get a return on balances thus generating extra income. As per our overall objectives, we ensure that these surplus balances are managed in a way to maximise the income potential whilst having regard to security risk.

2.2.2 The Council's investment strategy primary objectives, in order of importance are:

- safeguarding the re-payment of the principal and interest of its investments on time – losing any funds like in the case of Icelandic banks would be very significant in this financial climate;
- ensuring adequate liquidity – the Council does not want to run short of money so it cannot pay its bills or does not have money available to make investments in capital expenditure;
- maximising the investment return – this is clearly important but the Council does not want to maximise returns at the expense of the first two objectives.

2.2.3 The Council has only invested in agreed specified and non-specified investments listed in Appendix B, paras 1.8 and 1.11 of the Treasury Management Strategy. The current investment counterparty criteria selection approved in the Treasury Management Strategy Statement is meeting the requirement of the treasury management function.

2.3 How has the Council investments performed to Quarter2?

2.3.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. An example of a performance indicator often used for the investment treasury function is internal returns above the 6 month LIBOR rate (the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another). The Council monitored performance against the LIBOR rate for the first six months of 2017/18 and the results are shown below.

	2016/17	**2017/18 (Q1)**	**2017/18 (Q2) (Cumulative)**
RCC Returns (%)	0.75	0.68	0.66
LIBOR (%)	0.49	0.46	0.48

2.3.2 The Council is currently outperformed the LIBOR rate and this continues to reflect the decision made in 2016/17 Treasury Management Strategy to increase the higher maximum levels of investments within the middle limit category for UK banks from £2m to £5m.

2.3.3 The Bank Base Rate of 0.25% continues to affect the low interest rates offered by banks and building societies and is the main reason returns have fallen in 2017/18. There remains a possibility of an increase in the Rate during 2017/18. Further details can be seen in the narrative provided by Capita Asset Services in Appendix B paragraph 1.3.

3 PRUDENTIAL (BORROWING AND DEBT) INDICATORS

3.1 Why do we borrow?

3.1.1 Council's borrow to fund capital expenditure or refinance/reschedule existing borrowings e.g. replace one loan with one at a lower rate.

3.1.2 Effectively, the Council works out its capital expenditure plans and then calculates how much it needs to borrow having considered whether it should fund capital expenditure using other options.

3.2 What is our forecast Capital Expenditure in 2017/18 and how will we fund it?

3.2.1 The Council's forecast capital expenditure for 2017/18 is £10.1m. The Quarter 2 report (191/2017) contains detailed analysis of the revised capital programme and financing. The £10.1m was financed as per the table below. The financing need represents an increase in borrowing requirements.

	2017/18 Treasury Strategy Estimate*	**2017/18 Original Estimate ****	**2017/18 Revised Estimate**
	£000	**£000**	**£000**
Capital Expenditure	**6,250**	**9,975**	**10,080**
Financed by:			
Capital Receipts	177	882	438
Capital Grants & Contributions	5,673	8,388	9,040
Revenue	0	0	0
Total Financing	**5,850**	**9,270**	**9,478**
Net financing need for the year	**400**	**702**	**602**

* The Treasury Management Strategy report was presented to Cabinet on 14 February 2017, before the Capital Programme was approved.
** The 2016/17 Outturn Report 111/2017 updated the Capital Programme with 2016/17 carry forwards and additional capital schemes.

3.2.2 The £602k net financing need arises from the original decision to undertake prudential borrowing (albeit internal) to fund expenditure in relation to Digital Rutland.

3.2.3 The 2017/18 revised estimate for capital expenditure has increased from the 2017/18 original budget as detailed below.

Summary	**£000**
Approved Capital Programme 2017/18	4,308
Approvals, Reprofiling and Carry Forwards 2017/18	
- Outturn Report 2016/17	5,667
- Quarter 1 Report	105
- Quarter 2 Report	0
Revised Estimate	**10,080**

3.2.4 All of the movements are explained fully in the Quarter 1 (Cabinet report 147/2017) Finance Management Report.

3.3 What was the Council's borrowing need (the Capital Financing Requirement)?

3.3.1 Any unsupported borrowing in a given year is added to the Council's Capital Financing Requirement. The revised forecast for 2017/18 is £602k and this can be seen in paragraph 3.2.1.

3.3.2 The Council's Capital Financing Requirement (CFR) is simply the total capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. The CFR is reduced every year as the Council incurs a 'borrowing charge' in the Revenue Account which reduces it (this is called Minimum Revenue Provision).

3.3.3 The Council's CFR forecast for 2017/18 is shown below, and represents a key prudential indicator.

	2016/17 Actual	**2017/18 Original Estimate**	**2017/18 Revised Estimate**
	£000	**£000**	**£000**
CFR – 1 April	**22,724**	**22,755**	**22,755**
Movement in Year -			
Net financing need for the year (from table at para 3.2.1)	928	702	602
MRP	(897)	(872)	(872)

Total Movement in Year	31	(170)	(270)
CFR – 31 March	**22,755**	**22,585**	**22,485**

3.4 What is the current level of debt and how might it change?

3.4.1 The Council currently has loans outstanding of £22.436m of which £21.386m are long term loans with the Public Works Loans Board (PWLB). PWLB is managed as part of the UK Debt Management Office, which is a HM Treasury Executive Agency. The remainder comprises a Salix Loan of £420k repayable over 5 Years with the last payment in 2022 and a Local Enterprise Partnership (LEP) loan, which matures in 2023. The Salix and LEP loans are shown in the accounts at a concessionary rate which increases year on year until the final year where the full value is recognised. All PWLB loans have been borrowed on a maturity basis. Interest payments are made every six months on equal instalments throughout the term of the loan, with the principal being re-paid on the maturity date, the first maturity will be 19 January 2034. There has been no additional external debt taken out during the first six months of 2017/18.

3.4.2 The overall debt position is monitored continuously and advice provided by Capita Asset Services to identify opportunities for the repayment or restructuring of debt. No such opportunities were identified as cost effective during the period. Repayment of debt is subject to either a premium or dividend equating to the difference in interest payable for the remainder of the term of the loan and that which could be earned by the lender on a new loan for the same period. Recent rates have been significantly lower than that of debt in the current portfolio, making any premiums too high to be beneficial to the authority.

3.4.3 The latest advice from Capita, the Council's Treasury Management Advisors, indicates that the premium at 30 September 2017 was £16.675m. This would mean it would cost £16.675m in addition to the £21.386m principal totalling £38.061m, in order to repay the Council's PWLB loans.

3.5 What borrowing limits did we set and how did we comply?

3.5.1 The Council cannot simply borrow indefinitely. There are a number of prudential indicators to ensure the Council operates its activities within well-defined limits. The indicators focus on two key aspects:

- Setting limits to control borrowing; and
- Assessing the affordability of the capital investment plans.

3.5.2 In addition, we also set limits on interest rate exposure.

3.5.3 **Controlling borrowing prudential indicators**

3.5.4 The Council needs to ensure that its **gross debt does not, except in the short term, exceed the total of the CFR** in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This indicator is important as it effectively measures whether your actual external debt exceeds your need to borrow. If it does, then it could suggest that Councils have been borrowing for revenue purposes or when they do not need

to do so. Where gross debt is likely to exceed the CFR then Councils need to explain why

3.5.5 In the Councils case, in 2018/19, the Council may be in an “overborrowed” position as shown in the table below.   This position can be explained as follows:

a. The position has not materialised from borrowing for revenue purposes, which this indicator is a key test off. Since 2008 when the Council borrowed £4m PWLB for the bye-pass, the Council has taken only two loans i) an interest free loan from the Local Enterprise Partnership to contribute to the purchase and renovation of Oakham Enterprise Park (£630k); and ii) a Salix loan at 0% for Street Lighting upgrades (£420k). This borrowing is for capital purposes and not to fund revenue.

b. The Council has also made voluntary contributions to reduce its CFR as a means of reducing the capital financing charge on the revenue account. In 2013/14 the application of unused Capital Receipts was used to reduce the CFR by £1.4m and in 2015/16 to repay the advance borrowing in relation to Adult Soccer a reduction of £597k. If the Council had not done this, the CFR would £2m higher and the revenue account would receive a higher capital financing charge.

c. Ideally, to reduce interest costs, the Council would have preferred to use capital receipts etc. to repay external debt. However, there has not been a viable business case to do so. The Council would have to pay a premium to repay early, which would cost the Council in the long term more than repaying in line with the current loan on maturity.

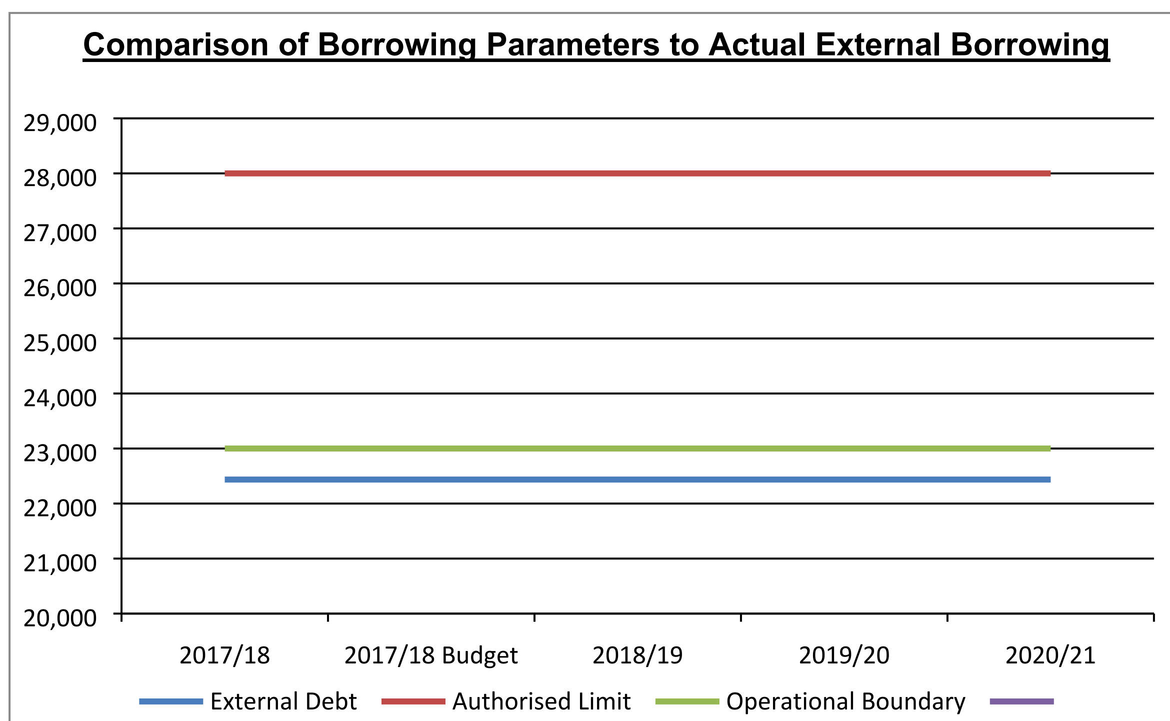
	2016/17 Actual £000	**2017/18 Revised Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**
Gross Debt	22,436	22,436	22,436	22,436
Capital Financing Requirement (CFR)	22,755	22,485	21,613	20,741
Under / (Over) borrowing	319	49	(823)	(1,695)

3.5.6 A further key prudential indicator represents a control on the maximum level of borrowing. The Council approved the Authorised Limit of £28m. This represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

3.5.7 An additional Indicator is the **Operational Boundary** – this is the maximum amount of money a council expects to borrow during the year. This is lower than the authorised limit and acts as a useful warning sign if it is breached during the year, which could mean that underlying spending may be higher or income

lower than budgeted. The council approved an operational boundary of £23m within the 2017/18 Treasury Strategy.

3.5.8 The graph overleaf compares the levels of External Debt (Para 3.4.1), Authorised Limit (3.5.6) and the Operational Boundary (3.5.7).



3.5.9 **Affordability Prudential Indicator**

3.5.10 The previous section covered the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

3.5.11 One of the key affordability indicators is the **ratio of financing costs to net revenue stream**. This indicator helps a council identify if borrowing costs become too high as a proportion of its budget. This is important as borrowing costs always have to be paid and are very hard to cut if resources fall.

	Original Estimate 2017/18 £000	**Forecast Quarter 2 2017/18 £000**
Financing Costs		
Capital Financing Costs	1.905	1.930
Interest Receivable	(0.180)	(0.220)
A	1.725	1.710
Revenue Stream		
Government Grants	5.533	6.166
Retained Business Rates	4.786	4.786

Council Tax	23.664	23.412
B	33.983	34.364
Ratio (A divided by B as a percentage)	5.08%	4.97%

3.6 Treasury Activity Limits

3.6.1 There are four treasury activity limits, which were previously prudential indicators. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- **Upper limits on variable interest rate exposure** – This identifies a maximum limit for variable interest rates based upon the debt position net of investments.
- **Upper limits on fixed interest rate exposure** – Similar to the previous indicator this covers a maximum limit on fixed interest rates.
- **Maturity structures 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.
- **Total principal funds invested for greater than 364 days** – These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

	2017/18 Original Estimate £000	**2017/18 Revised Estimate £000**
Interest rate exposures		
	Upper	**Upper**
Limits on fixed interest rates	25,000	25,000
Limits on variable interest rates	7,500	7,500

3.6.2 **Maturity Structures Of Borrowing –** These gross limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing

Maturity structure of fixed interest rate borrowing 2017/18		
	Upper	**Lower**
Under 12 months	25%	0%
12 months to 2 years	25%	0%
2 years to 5 years	20%	0%
5 years to 10 years	20%	0%

10 years and above	100%	0%
Maximum principal sums invested > 364 days	25%	

Appendix B. Capita Asset Services Commentary on The Economy and Interest Rates

1 ECONOMICS UPDATE

1.1 **UK.** After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. . The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

1.2 The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

1.3 It therefore looks very likely that the MPC will increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were

to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

1.4 **EU.** Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

1.5 **USA.** Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017 which would then lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

1.6 **China.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

1.7 **Japan** is struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

2 INTEREST RATE FORECASTS

2.1 The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

2.2 Capita Asset Services undertook its last review of interest rate forecasts on 9 August after the quarterly Bank of England Inflation Report. There was no change in MPC policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.

2.3 The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU, and when.

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

- 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.
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and to get inflation up consistently to around monetary policy target levels.

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

- 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 causing an increase in the inflation premium inherent to gilt yields.

Appendix C. Treasury Management Glossary of Terms

Authorised Limit (Also known as the Affordable Limit): A statutory limit that sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities).
Balances and Reserves: Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.
Bank Rate: The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". This rate is also referred to as the 'repo rate'.
Basis Point: A unit of measure used in finance to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent). In most cases, it refers to changes in interest rates and bond yields. For example, if interest rates rise by 25 basis points, it means that rates have risen by 0.25% percentage points. If rates were at 2.50%, and rose by 0.25%, or 25 basis points, the new interest rate would be 2.75%.
Bond: A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.
Capital Expenditure: Expenditure on the acquisition, creation or enhancement of capital assets.
Capital Financing Requirement (CFR): The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.
Capital Receipts: Money obtained on the sale of a capital asset.
Credit Rating: Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.
Counterparty List: List of approved financial institutions with which the Council can place investments with.
Debt Management Office (DMO): The DMO is an Executive Agency of Her Majesty's Treasury and provides direct access for local authorities into a government deposit facility known as the DMADF. All deposits are guaranteed by HM Government and therefore have the

equivalent of a sovereign triple-A credit rating.

Gilts:

Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged'. Being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.

LIBID:

The London Interbank Bid Rate (LIBID) is the rate bid by banks on Eurocurrency deposits (i.e. the rate at which a bank is willing to borrow from other banks).

LIBOR:

The London Interbank Offered Rate (LIBOR) is the rate of interest that banks charge to lend money to each other. The British Bankers' Association (BBA) work with a small group of large banks to set the LIBOR rate each day. The wholesale markets allow banks who need money to be more fluid in the marketplace to borrow from those with surplus amounts. The banks with surplus amounts of money are keen to lend so that they can generate interest which it would not otherwise receive.

Maturity:

The date when an investment or borrowing is repaid.

Money Market Funds (MMF):

Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.

Minimum Revenue Provision (MRP):

An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets.

Voluntary Revenue Provision (VRP):

An additional contribution over and above the MRP that the Council can choose to make to reduce the CFR which in turn will reduce the MRP for future years.

Non Specified Investment:

Investments which fall outside the CLG Guidance for Specified investments (below).

Operational Boundary:

This linked directly to the Council's estimates of the CFR and estimates of other day to day cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

Prudential Code:

Developed by CIPFA and introduced on 01/4/2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.

Prudential Indicators:

Prudential indicators are a set of financial indicators and limits that are calculated in order to demonstrate that councils' capital investment plans are affordable, prudent and sustainable.

They are outlined in the CIPFA Prudential Code of Practice. They are indicators that must be used to cover the categories of affordability, prudence, capital spending, external debt/borrowing and treasury management. They take the form of limits, ratios or targets which are approved by Council before 1 April each year and are monitored throughout the year on an on-going basis. A council may also choose to use additional voluntary indicators.

Public Works Loans Board (PWLB):

The PWLB is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

Revenue Expenditure:

Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.

(Short) Term Deposits:

Deposits of cash with terms attached relating to maturity and rate of return (Interest).

Specified Investments:

Term used in the CLG Guidance and Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than one year. UK government, local authorities and bodies that have a high credit rating.

Supported Borrowing:

Borrowing for which the costs are supported by the government or third party.

Temporary Borrowing:

Borrowing to cover peaks and troughs of cash flow, not to fund capital spending.

Unsupported Borrowing:

Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.

Yield:

The measure of the return on an investment.