Appendix A. Treasury Management Strategy 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 It is very important that Councils understand the risks that are associated with treasury management, as highlighted by the collapse of the Icelandic banks a number of years ago, which put at risk substantial funds that had been invested. The key treasury management risks are:

- Credit risk – the risk that a bank or other institution will not be able to pay back the money invested in them.
- Interest rate risk – the risk that a council's budget will be adversely affected by unforeseen changes in interest rates.
- Liquidity risk – the risk that a council will have funds tied up in long-term investments when it needs to use that money.
- Refinancing risk – the risk that when loans and investments reach the end of their term, a council will not be able to re-borrow or reinvest the money on acceptable terms or interest rates.
- Legal and regulatory risk – the risk that unforeseen legal and regulatory changes have an adverse impact on a council.

1.2.3 A council is required to approve a treasury management strategy, which sets out how it will borrow and invest money and manage those risks.

1.2.4 Before 2004, there was a very complicated framework of rules and regulations that controlled how councils were allowed to invest in assets and the amount that they could spend. April 2004 saw the introduction of CIPFA's The Prudential Code for Capital Finance in Local Authorities. The Prudential Code provides a framework within which councils can judge for themselves whether capital investment is

affordable, prudent and sustainable in the year in question and in future years. The Prudential Code is given statutory backing, which means that councils are required to ‘have regard’ to it, by the Local Government Act 2003 (in England and Wales).

1.2.5 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.

1.3 **What are the reporting requirements?**

1.3.1 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

1.3.2 **Treasury Management Strategy** - The first, and most important report covers:

- 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.

1.3.3 **Mid Year Treasury Management Report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

1.3.4 **Annual Treasury Report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

2 INVESTMENT STRATEGY

2.1 Why do we invest?

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 At any point of time in the year, the Council can have between £19m - £32m available to invest. The estimated level of investments at year end based on the current cash flow calculations and for the next few years is shown below. The Total investments at Quarter 2 show the estimated level of investment at the mid-point during the financial year.

	2016/17 Actual £000	2016/17 Forecast £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Total Investments at Quarter 2	28,880		30,047	28,101	25,655
Total Investments at 31 March		22,586	22,535	21,076	19,241

2.1.3 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 What are our investment objectives?

2.2.1 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;
- 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.

2.2.2 These objectives filter through this strategy.

2.3 What types of investments do we make and who with? What rules do we work to?

2.3.1 In order to safeguard the Council's funds, the Council has various rules in place which determine what type of investment is made and who with. As noted above, the primary principle governing the Council's investment criteria is the security of

its investments, although the yield or return on the investment is also a key consideration.

2.3.2 The Council's investment decisions adhere to the following rules:

- **The Council will only invest in agreed specified and non specified investments** (the list is given in Appendix B) – any investment option not on the list cannot be pursued for instance local authorities cannot invest directly on the stock exchange;

- In investing in specified and non –specified investments, **the Council will only invest with high quality counterparties** e.g. whilst the Council can place investments with banks (these are specified investments), it will only do so if the bank meets a certain creditworthiness as defined by the three main credit agencies, Fitch, Moody's and Standard and Poors (Appendix B sets out the criteria for credit worthiness). The Council will also make use of other operational market information where relevant before placing investments.

- **The Council sets time periods and limits** on various types of investment (Appendix B gives detail). If the Council did not do this then officers could theoretically make a sizeable investment for a long period of time leaving the Council short of working capital.

- **The Council sets a maximum level of risk based on the historic risk of default.** The risk rating is represented by a % likelihood of investments being defaulted on over a 12 month period. The ratings are produced by Capita. The guideline amount is set at 0.100% across the whole portfolio. This benchmark is a simple target (not a limit) to maximum risk, so may be exceeded from time to time, depending on movements in interest rates and counterparty criteria. Any time the Council exceeds the benchmarks, this will be reported, with supporting reasons in the Mid-Year or Annual Report.

2.4 **How long do we invest for?**

2.4.1 The Council needs to manage its liquidity risk – it does not want to hold too much money but equally it does not want to run short of money. The CIPFA Treasury Management Code of Practice defines liquidity as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives".

2.4.2 Notwithstanding the investment rules above which mean there are agreed time periods for certain investments, the Council seeks to maintain:

- Bank overdraft - £0m

- Liquid short term deposits of at least £1m available with a week's notice.

2.4.3 All investments will be made ensuring that at least £1m is available within a weeks' notice.

2.5 **What type of returns do we achieve?**

2.5.1 This will depend on economic conditions and type of investments we make. In 2016/17 the Council forecasts to make interest of £228k on investments of c£30m giving an overall return of c0.70%.The in-year performance is included within the Quarterly Finance report. The latest report is the 2016/17 Q3 report (37/2017). Following the reduction in Bank Base Rate in August 2016 from 0.50% to 0.25% investment interest rates have also reduced. The effect of this is that return on investments has reduced from 0.81% in Quarter 2 to a forecast year end return of c0.70%

2.5.2 Over the medium term, the Council expects to make returns as shown in the table below. The investment interest income forecast is:

2016/17 £000	2017/18 £000	2018/19 £000	2019/20 £000
254*	180	210	170

* The Council also receives interest from sources other than investments. A Housing Association is recharged the principal and interest for loans that the Council has made to it, the final payment will be in 2051/52 (£13k 2016/17). In 2016/17 £13k was received from the sale of buses and from the delayed sale of Barleythorpe Hall.

2.5.3 These returns assume interest rates follow the trends as set out by Capita. Capita have provided their view of future interest rate and other market movements upon which our assumptions are based (see Appendix E). Bank Base Interest Rate Forecasts 2017-18 (provided by Capita) are shown below.

Jan-17	Apr-17	Jun-17	Sep-17	Jan-18	Apr-18	Jun-18
0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%

2.6 **How is performance measured?**

2.6.1 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 will again monitor performance against the LIBOR rate in 2017/18.

	2015/16	2016/17 (Q3)
RCC Returns	0.71%	0.81%
LIBOR	0.59%	0.53%

2.7 **Who makes investment decisions?**

2.7.1 The Assistant Director Finance (S151 Officer) is responsible for the overall management of the authority's investment, borrowing and other capital financing arrangements, but delegates day to day treasury management activity to other officers. The Assistant Director Finance (S151 Officer) and the delegated officers

maintain records of all borrowings and lending of money by the Council.

2.7.2 Officers prepare and monitor cash flows and borrowing during the year and will invest or recall funds in order to maximise returns with secure counterparties and to ensure the Council's bank accounts are not overdrawn.

2.7.3 Officers attend regular regional awareness seminars, provided by Capita and attend appropriate technical training courses that are provided by CIPFA. On the job coaching and supervision is an integral part of officer training

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

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

2.7.6 The Council currently uses Capita Asset Services as its external treasury management advisors, which provides a range of services which includes generic investment advice on interest rates, timing and investment instruments; and credit ratings/market information service comprising the three main credit rating agencies.

3 BORROWING STRATEGY

3.1 Why do we borrow?

3.1.1 Council's borrow to fund capital expenditure or refinance/reschedule existing borrowing e.g. replace one loan with one at a lower rate. There are 7 types of borrowing that may be considered under this strategy.

a) Borrowing to fund a scheme that will reduce the Council's ongoing revenue costs in future years, or avoid increased costs in future years.

b) Borrowing to fund the purchase of essential vehicles plant and equipment in order to maintain Council functions.

c) Borrowing in advance of anticipated receipts to enable the Council to invest in capital expenditure before it has the income to fund the investment.

d) Borrowing to enable the Council to fund a larger capital programme than it is able to do using Government grant and self-financed borrowing.

e) Borrowing to fund an overspend on a large-scale capital scheme that would otherwise have to be funded from a revenue contribution to capital outlay, with major impact on the council's revenue budget.

f) Borrowing to fund a capital development which the Council believes is so essential to the transformation of Rutland, and able, within the context of setting a robust budget and medium term financial strategy, to allocate to the development a specific, ongoing, relatively secure source of funding that can clearly be seen to be able to cover the cost of debt financing for the project over its expected life.

g) Borrowing to reschedule existing borrowing i.e. replace existing loans with others.

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 are the Council's borrowing objectives?

3.2.1 The Council's objectives are to:

- fund the capital programme in line with 3.1;
- avoid external borrowing as far as possible i.e. use other sources of funding first where possible;
- repay borrowing early if this is financially prudent and viable;
- reduce its borrowing charge if this represents value for money;
- ensure any new borrowing is affordable.
- work within prudential indicator limits.

3.2.2 Capital expenditure can actually be funded in different ways, borrowing is just one option. Each way is different and can have a different impact. The table below explains the options including borrowing.

Source	Description	Advantages	Disadvantages
1. Revenue	Councils are free to make a contribution from their revenue budget to fund capital schemes - this is known as direct revenue financing. There are no limits on this. Funding from revenue means the Council gets one-off revenue "hit" to the value of the contribution/asset.	• By funding capital in one go or from revenue – we don't need to externally borrow so avoid paying high interest costs or a borrowing charge in the Revenue account	• We cannot do this if we do not have revenue balances – a lot of Council's don't do it these days for this reason • Once the revenue balances are gone they cannot be used again and it can be hard to build them up • Council's investment income goes down because by reducing balances a Council has less invested and so earns less interest
2. Capital receipts	This is the money received from the disposal of capital assets – the rules say that Councils can only use capital receipts for repayment of debt or to finance new capital expenditure	• By funding capital via receipts – we don't need to externally borrow so avoid paying high interest costs or a borrowing charge in the Revenue account	• Once the capital receipts are gone they cannot be used again • Council's investment income goes down because by spending receipts a Council has less invested and so earns less interest
3. Grants and contributions	These can come from central government or other organisations – the Council gets a few capital grants. They cannot be used for anything else but funding capital.	• By funding capital via grants – we do not need to externally borrow so avoid paying high interest costs or a borrowing charge in the Revenue account	• Once the grants are gone they cannot be used again • Council's investment income goes down because by spending grant income a Council has less invested and so earns less interest
4. External	Councils can borrow money to	• Councils can progress	• It is not always an option – Council's

Source	Description	Advantages	Disadvantages
borrowing	pay for capital assets – most Councils borrow through the Public Works Loan Board (PWLB), a bank or other lender	schemes rather than wait until funding is available • Council's do not deplete any of their existing balances by borrowing	set a borrowing limit which they try and work within • Generally more expensive than using grants etc as the loan interest rate is usually higher than what the Council can earn on investments • There is a borrowing cost charged to the Revenue account as well as interest costs
5. Section 106	Use of section 106 funds from planning developments can be used for capital or revenue. As the purpose of 106 is to invest in infrastructure to support development then it tends to be capital	• By funding capital via s106 – we do not need to externally borrow so avoid paying high interest costs or a borrowing charge in the accounts	• Once Section 106 is gone it cannot be used again • Council's investment income goes down because by spending s106 income a Council has less invested and so earns less interest
6. Using cash balances (self-financing)	Councils can use their internal resources, cash balances, to meet capital expenditure Funding from cash balances means the Council does not get a one-off revenue "hit" but the cost is spread over time.	• By funding capital via internal resources – we do not need to externally borrow so avoid paying high interest costs • Even though a Council might spend £1m today, the Revenue 'hit' is spread over time e.g. £20k a year over 50 years – that's the way the rules work	• Generally more expensive than using grants/revenue or capital receipts because there is a borrowing cost charged to the Revenue account (but no interest costs) • Council's investment income goes down because by using cash balances a Council has less invested and so earns less interest

3.2.3 Typically, the most expensive option is externally borrowing so Councils will do what they can to avoid that. This is a key objective for this Council. As noted above, a Council cannot use capital grants or capital receipts for anything else so it makes no sense to externally borrow if you have these resources available and do not have future plans to use them.

3.3 Can we borrow in advance of need?

3.3.1 The Council has some flexibility to borrow funds in advance of need for use in future years. The Section 151 Officer may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Section 151 Officer will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 50% of any expected increase in borrowing need (CFR – see para 3.5) over the three year planning period;
- The Section 151 officer would not look to borrow more than 18 months in advance of need; and
- Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

3.3.2 To date the Council has never borrowed in advance of need and there are no plans currently to undertake any borrowing in advance of need.

3.4 What are our Capital Expenditure plans and how do we plan to fund them?

3.4.1 The Council's capital expenditure plans are summarised below.

	2016/17 Original £000	**2016/17 Forecast Q2 £000**	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**
Capital Expenditure	**7,027**	**8,292**	**6,250**	**7,883**	**3,858**
Financed by:					
Capital Receipts	306	806	177	150	150
Capital Grants & Contributions	5,325	5,770	5,673	7,733	3,708
Revenue	186	186	0	0	0
Net financing need for the year	**1,210**	**1,530**	**400**	**0**	**0**

3.4.2 This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc. or revenue resources). As the table demonstrates the capital programme in future years is largely grant funded expenditure. For 2018/19 and 2019/20 the figures are indicative and could change as grants awarded and projects approved by Cabinet/Council.

3.4.3 If these resources are insufficient to fund the capital programme, then any residual capital expenditure will add to the Council's borrowing need. This is the case in 2017/18, where Digital Rutland will require financing of £400k.

3.4.4 Where the Council adds to its borrowing need, capital expenditure is described as **unsupported**. This unsupported capital expenditure needs to have regard to:

- Service objectives (e.g. strategic planning);
- Stewardship of assets (e.g. asset management planning);
- Value for money (e.g. option appraisal);
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- Affordability (e.g. implications for the council tax); and
- Practicality (e.g. the achievability of the forward plan).

3.4.5 This is because unsupported capital expenditure will need to be paid for from the Council's own resources. In the case of Digital Rutland a decision was made previously to support this project when the above factors were considered.

3.5 What is the Council's borrowing need (the Capital Financing Requirement)?

3.5.1 Any unsupported borrowing in a given year is added to the Council's Capital Financing Requirement. For 2017/18 this would be £400k for Digital Rutland

3.5.2 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 capital expenditure above which has not immediately been paid for will increase the CFR. Note 20 in the Statement of Accounts shows the closing CFR of £22,725 for 2015/16. The CFR is reduced every year as the Council incurs a 'borrowing charge' in the Revenue Account which reduces it (this is called MRP which is explained in 3.7)

3.5.3 Approval is sought for the CFR projections below.

	2016/17 Forecast Q2 £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
CFR – 1 April	**22,724**	**23,357**	**22,885**	**22,036**
Movement in Year - CFR	633	(472)	(849)	(826)
CFR – 31 March	**23,357**	**22,885**	**22,036**	**21,210**
Movement in CFR Represented by				
Net financing need for the year (from table at para 3.4.1)	1,530	400	0	0
MRP	(897)	(872)	(849)	(826)
Movement in CFR	**633**	**(472)**	**(849)**	**(826)**

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

3.6.1 The Council currently has loans outstanding of £22,436,000 of which £21,386,000 are long term loans with the Public Works Loans Board (PWLB). Details of the outstanding loans can be found at Appendix D. PWLB is managed as part of the UK Debt Management Office, which is a HM Treasury Executive Agency. The remainder is a £630k Local Enterprise Partnership interest free loan which matures in 2023, and an interest free Salix loan of £420k repayable in 2020.

3.6.2 Included within the £21.386m is £8.232m of debt that was inherited from Leicestershire in the Local Government Re-organisation in 1997. The last time the Council actually borrowed from the PWLB was in 2008 to contribute towards funding the Oakham bypass, the value of this loan was £4m.

3.6.3 All PWLB loans have been borrowed on a maturity basis. Interest payments will be

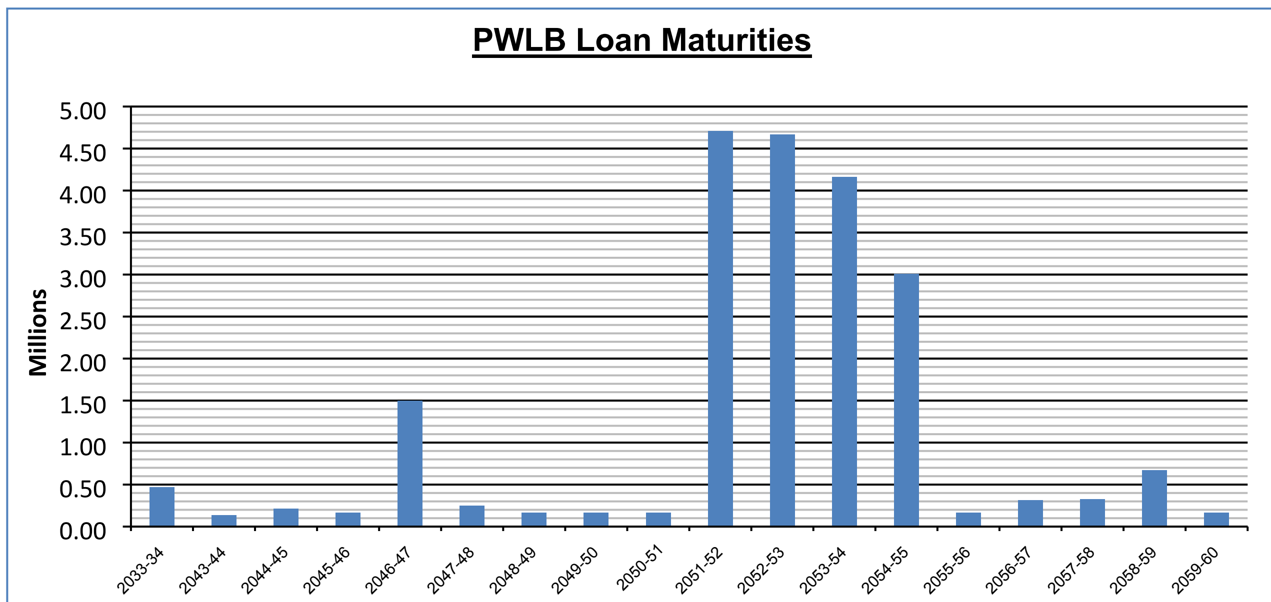
made every six months on equal instalments throughout the term of the loan, with the principal being re-paid on the maturity date.

3.6.4 The external debt projections (2017/18 to 2019/20) are shown below. The Council is not expecting external debt to increase in line with its overall strategy.

	2016/17 Forecast £000	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**
External Debt				
Debt at 1 April	22,436	22,436	22,436	22,436

3.7 **When is debt due and can/will we repay it early?**

3.7.1 The table below shows that debt is not due to be repaid for some time. Appendix D also shows the position of the PWLB loans as at 31 December 2016. The premium column reflects the additional payment which would be have to be made if any of the loans were repaid prematurely or the loans restructured.



3.7.2 It is possible to prematurely repay the loans but dependent on the interest rates at the time it may not be beneficial. If the PWLB agrees to accept a premature repayment, it will calculate a repayment sum, which is the total amount the authority must pay to discharge its liabilities to the PWLB in respect of that loan. This sum may include a discount or premium on the outstanding principal according to whether the discount rate is higher or lower than the loan rate.

3.7.3 The repayment sum will be higher than the principal amount borrowed if interest rates are presently lower than the loan rate. It will be lower than the principal amount if the current interest rates are higher than the loan rate. In effect, the amount of principal is being adjusted to reflect the detriment or benefit to the

PWLB of foregoing the remaining instalments of interest, and receiving funds which have to be re-invested at current interest rates. Forecast PWLB Interest Rates (Provided by Capita) are shown below.

	5 Year %	10 Year %	25 Year %	50 Year %
Mar-17	1.60	2.30	2.90	2.70
Jun-17	1.60	2.30	2.90	2.70
Sep-17	1.60	2.30	2.90	2.70
Dec-17	1.60	2.30	3.00	2.80
Mar-18	1.70	2.30	3.00	2.80
Jun-18	1.70	2.40	3.00	2.80
Sep-18	1.70	2.40	3.10	2.90
Dec-18	1.80	2.40	3.10	2.90
Mar-19	1.80	2.50	3.20	3.00
Jun-19	1.90	2.50	3.20	3.00
Sep-19	1.90	2.60	3.30	3.10
Dec-19	2.00	2.60	3.30	3.10
Mar-20	2.00	2.70	3.40	3.20

3.7.4 The Council takes advice from its treasury advisors as to whether it would be financially beneficial to pay off debt. Here is an example calculation that is undertaken:

- Loan value to repay £2m
- Interest rate 4.4%
- Years left 36
- Early redemption premium £1.014m
- Average interest rates over 36 years 2.5% (estimated)

3.7.5 If the Council pays off the loan, it incurs a charge of £1.014m and “loses” 2.5% pa interest on £2m (Interest on investments will also decrease as the funds will reduce following the repayment) of £50k pa so over 36 years would lose in total £1.8m. Conversely, by paying off the loan the Council saves interest of £88k (£2m x 4.4% pa) over 36 years = £3.17m.

3.7.6 In this example, the decision is marginal as the total cost would be £2.9m with the interest savings being £3.17m. If the Council thought average interest rates were going to be above 2.5% it therefore might NOT pay off the loan as if interest rates were 3.5% this would result in the total cost being £3.5m (£2.5m lost interest plus £1m premium). If the Council thought interest rates would be on average less than

2.5% over 36 years it might PAY off the loan.

3.7.7 Faced with decisions like this, Officers, taking advice from Capita, have not recommended that loans are repaid. Whilst interest rates are currently low, the Council does not have enough certainty to predict what the rates might be over the long term. For example in the 2000s the average interest rate was c4.3%. As most loans are not due until over 20 years' time, the Council would take a risk in paying off loans now. In addition, the value for money calculation is only one consideration. If the Council can afford debt repayments then it could choose not to use balances to repay debt, instead keeping balances available to invest in new projects.

3.7.8 On this basis, the Council does not envisage repaying any loans in the near future, but this position will be kept under review.

3.8 What is the cost of borrowing? How is this shown in the Revenue Account?

3.8.1 When the Council borrows there are two types of costs:

- Interest (Incurred annually on the amount borrowed at a set rate) as covered by 3.6.3; and
- Minimum Revenue Provision.

3.8.2 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

3.8.3 When the Council meets capital expenditure through prudential borrowing (options 4 and 6 in table 3.2.2), it incurs a 'borrowing charge' in its Revenue Account. The 'borrowing charge' spreads the cost over the time period of the useful life of the asset. The manner of spreading these costs is through an annual Minimum Revenue Provision. For example, if the Council self-finances borrowing of £5m for a new School (with an asset life of 50 years), it would incur a charge of £100k in its Revenue Account for a 50 year period.

3.8.4 There are four different ways of calculating MRP, however options 1 and 2 can only be used for expenditure incurred before 2008.

- Option 1 Regulatory Method - This relates to debt supported by Government through RSG system. Authorities are able to calculate MRP as though the regulations 28 and 29 of the 2003 regulations had not been revoked.
- Option 2 Capital Financing Method - This is option is used in relation to supported debt and the MRP is equal to 4% of the General Fund Capital Financing requirement.
- Option 3 Asset Life (i) (Equal Instalment) Method and Asset Life (ii) (Annuity) Method - These options relate to new unsupported borrowing. It allows the use of a simple formula to calculate a series of equal amounts chargeable over the estimated life of the asset.

- Option 4 Depreciation Method - This option allows MRP to equal the provision required in accordance with the standard rules for depreciation accounting in respect of the asset.

3.8.5 The Council uses:

- Option 2 – for expenditure incurred Pre 01/04/2008.

- Option 3 – Equal instalment method on the Capital Finance Requirement Post 01/04/2008

3.8.6 The combination of the two options resulted in an annual charge to the general fund of £897k during 2016/17.

3.8.7 In addition to the statutory amounts the Council can choose to make additional Voluntary Revenue Provision (VRP). This is where the Council applies additional resources to reduce the future MRP liability by applying a voluntary contribution now. For example, if the Council received a capital receipt of £1m, it could apply this as a VRP against Option 2 saving the Council £40k pa. However, it would then not be able to use the capital receipt to fund capital expenditure.

3.8.8 It is recommended that the existing method of calculating MRP is continued and that no VRP is made for now.

3.9 **What are the limits to borrowing activity?**

3.9.1 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.

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

3.9.3 <u>**Controlling borrowing prudential indicators**</u>

3.9.4 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 2016/17 and the following two financial years. This indicator is important as it effectively measures whether actual external debt exceeds the 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

3.9.5 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 Forecast Q3 £000	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**
Gross Debt	22,436	22,436	22,436	22,436
Capital Financing Requirement (CFR)	23,357	22,885	22,036	21,210
Under / (Over) borrowing	921	449	(400)	(1,226)

3.9.6 A further key prudential indicator represents a control on the maximum level of borrowing. The Council is asked to approve the following **Authorised Limit**. 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

3.9.7 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

3.9.8 The table below shows that Council are being asked to approve an authorised limit of £28m.

	2016/17 Forecast Q3 £000	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**
Borrowing	28,000	28,000	28,000	28,000
Other Long Term	0	0	0	0

Liabilities				
Total	28,000	28,000	28,000	28,000

3.9.9 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.

	2016/17 Forecast Q3 £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
External Debt				
Debt at 1 April	22,436	22,436	22,436	22,436
Expected change in debt	0	0	0	0
Debt at 31 March (1)	22,436	22,436	22,436	22,436
Operational boundary	23,000	23,000	23,000	23,000
The debt estimated at 31 March represents the Council's Operational Boundary				

3.9.10 The table above shows that Council are being asked to approve an operational boundary of £23.0m. This has been calculated by taking the existing debt level (£22m) and allowing slight head room for additional borrowing although current plans do not include any additional borrowing over the life of the Medium Financial Plan.

3.9.11 **Affordability Prudential Indicators**

3.9.12 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. The Council is asked to approve the following indicators:

3.9.13 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.

	£000	
Capital Financing Costs	1.905	
Interest Receivable	(0.180)	
	1.725	A

Revenue Stream		
Government Grants	5.418	
Retained Business Rates	4.786	
Council Tax	23.241	
	33.445	B
Ratio (A divided by B as a percentage)	5.16%	

	2016/17 Original Estimate £000	**2016/17 Forecast Q2 £000**	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**
Ratio	5.06%	5.01%	5.16%	5.01%	4.97%

3.9.14 The estimates of financing costs include current commitments and the proposals in this report. The table below shows the Council's figures compare relative to neighbouring authorities.

	2016/17 Original Estimate	**2017/18 Estimate**	**2018/19 Estimate**
Rutland	5.06%	5.16%	5.01%
Peterborough City Council	8.30%	8.50%	8.50%
Northamptonshire County Council	9.70%	10.10%	10.00%
Leicestershire County Council	8.39%	7.25%	7.20%
Nottingham City Council	14.71%	14.92%	-

3.9.15 Another indicator of affordability is the ratio of **estimates of the incremental impact of capital investment decisions on the Council Tax**. Because all councils' borrowing is secured against future income including the council tax, ultimately all borrowing would have to be collected from council tax payers if no other income was available. It is therefore important to understand the impact of decisions on future council tax.

3.9.16 This ratio is calculated by adding the estimated additional MRP and interest costs for the forecast Capital Programme. This is divided by the Council Tax Base resulting in a Band D Council Tax charge for these additional costs. The figures below show the proportion of this against the total Band D Council Tax.

	Projection 2017/18	Projection 2018/19	Projection 2019/20
Council Tax - Band D	0.28%	0.31%	0.10%

3.9.17 **Limiting Interest Rate Exposure**

3.9.18 There are three further treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will reduce the opportunities officers have 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.

The Council is asked to approve the limits:

	2016/17	2017/18	2018/19
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates	£25.000m	£25.000m	£25.000m
Limits on variable interest rates	£7.500m	£7.500m	£7.500m
Maturity structure of fixed interest rate borrowing 2016/17			
		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%	

3.10 **Who makes borrowing decisions?**

3.10.1 As with investments, the Assistant Director Finance (S151 Officer) is responsible for the overall management of the authority's investment, borrowing and other capital financing arrangements.

3.10.2 Any proposal to amend the capital programme (which includes the resources allocated to schemes and resources available but not allocated at the time the budget is approved) requires the formal approval of Cabinet unless the Scheme is above £1m and/or is to be funded from new resources e.g. new borrowing or s106 funds in which case Council will make the decision. Whilst Council or Cabinet will decided whether borrowing is required, it is for the Section 151 Officer to determine how this requirement is met either through self-financing or external borrowing.

3.10.3 As highlighted in 3.3, the Section 151 Officer may also borrow where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints.

Appendix B. Investment Counterparty Selection Criteria

1 INVESTMENT COUNTERPARTY SELECTION CRITERIA

1.1 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure:

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

1.2 The Section 151 Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality the Council may use rather than defining what its investments are.

1.3 The rating criteria use the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009.

1.4 Credit rating information is supplied by our treasury consultants daily on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to counterparty will be suspended from use, with all others being reviewed in light of market.

1.5 The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is shown in the table overleaf.

Investment Counterparty	Description	Criteria
Banks	Financial institution licensed as a receiver of deposits. There are two types of banks: 1. Commercial/retail banks; and 2. Investment banks.	i. Are UK banks; and/or ii. Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AA+. And have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated): i. Short Term - Fitch (or equivalent) rating of F1 ii. Long Term - Fitch (or equivalent) rating of A-
Part Nationalised Banks	A nationalised bank is owned by the state, usually because the state bought a private bank, or at least bought a controlling share in it. Any profits a nationalised bank makes go to the state. Losses are borne by the taxpayer.	These banks can be included if they continue to be part nationalised or they meet the criteria in Banks above.
Council Banker	As for banks above, but is the principal banker for the authority.	Criteria for banks above, however, if the bank falls below the criteria it will be able to hold funds to meet its statutory obligations.
Building Society	A financial organisation which pays interest on investments by its members and lends capital for the purchase or improvement of houses.	i. have the minimum credit ratings as detailed in paragraph Banks 1 above; ii. has assets in excess of £1bn.
Money Market Fund	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.	Deal with funds with Counterparties on the approved list. The Council limits the total investment to the amount on the approved counterparty list if below limits in 1.9
UK Government	Investing in the UK Government will normally take the form of 1. Gilts - fixed-interest loan securities issued by the UK government. 2. Debt Management Account Deposit Facility (DMADF) - designed to support local authorities' cash management. The key objective of the DMADF is to provide users with a flexible and secure facility to supplement their existing range of investment options while saving interest costs for central government.	There is no criteria, other than the limits set out in 1.9, due to the security of the investment.

Investment Counterparty	Description	Criteria
Local Authorities, Parish Councils etc	Other administrative bodies in local government	There is no criteria, other than the limits set out in 1.9, due to the security of the investment.
Property Funds (See Appendix C for further detail)	A type of security that invests in property (See Appendix C for further detail)	There are no criteria currently set, other than the limits set out in 1.9. Full criteria will be presented to Cabinet before any dealing is undertaken.

A limit of 80% will be applied to the use of Non-Specified investments (*this will partially be driven by the long term investment limits*).

1.6 **Country and sector considerations** - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above. In addition:

- no more than 10% (of the total investment portfolio) will be placed with any non-UK country at any time;
- limits in place above will apply to Group companies;
- Capita Asset Services limits will be monitored regularly for appropriateness.

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

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

- The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
- A local authority, parish council or community council.
- Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 3 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.

- A body that is considered of a high credit quality (such as a bank or building society). For category 4 this covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

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

	Fitch Rating	**Moody's Rating**	**Standard & Poor's Rating**	**Money Limit**	**Time Limit**
Upper limit category	F1+/ AA-	P-1/Aa3	A-1+/AA-	£5m	3 years
Middle Limit Category	F1/A-	P-1/A3	A-2/A-	£5m	364 days
Other Institution Limits (other Local Authorities, Money Market Funds, DMADF)				£5m	364 days
Guaranteed Organisations				Within the terms of the guarantee to a maximum of £1m up to 6 months	

1.10 **Definition of Ratings**

- A-1 - A short-term obligation rated 'A-1' is rated in the highest category by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is strong. Within this category, certain obligations are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitment on these obligations is extremely strong.
- **A-2** - A short-term obligation rated 'A-2' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rating categories. However, the obligor's capacity to meet its financial commitment on the obligation is satisfactory.
- **A-3** - A short-term obligation rated 'A-3' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

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

		Limit £
A	Building Societies not meeting the requirements under specified investments – the operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies. The Council may use such building societies which were originally considered Eligible Institutions and have a minimum asset size of £1bn but will restrict these investments to a maximum of £1m for up to 6 months.	£1m for up to 6 months
B	Gilt edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. The value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity	£5m for up to 3 years
C	A body which has been provided with a government issues guarantee for wholesale deposits within specific timeframes. Where these guarantees are in place and the government has an AAA sovereign long term rating these institutions will be included within the Council's criteria temporarily until such time as the ratings improve or the guarantees are withdrawn. Monies will only be deposited within the timeframe of the guarantee.	Within the terms of the guarantee to a maximum of £1m up to 6 months.
D	The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	
E	Property Funds - The use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using.	£2m

1.12 **The Monitoring of Investment Counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Capita daily, when ratings change, and counterparties are checked. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Section 151 Officer, and if required new counterparties which meet the criteria will be added to the list.

1.13 **Economic Investment Considerations** - Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood of the current 0..25% Bank Rate remaining for the near future. The Council's investment decisions are based on comparisons between the rises priced into market rates against the Council's and advisers own forecasts.

1.14 The criteria for choosing counterparties set out above provide a sound approach to investment in “normal” market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Section 151 Officer may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to “normal” conditions. Similarly the time periods for investments will be restricted.

Appendix C. - PWLB Debt Analysis

1 PUBLIC WORKS LOAN BOARD (PWLB) DEBT ANALYSIS

1.1 The table below shows the number of outstanding loans with the PWLB, the maturity date, Principal outstanding, interest rate and the premium payable if the council was to settle the outstanding loan.

PWLB 2016-17 Loan Repayment Premiums as at 20-Jan-17					
Loan Reference	**Start Date**	**Maturity Date**	**Principal Balance**	**Interest Rate %**	**Premium**
461697	27-Mar-1987	31-Dec-2043	132,529.13	9.000	£196,620
461698	27-Mar-1987	31-Dec-2044	212,550.13	9.000	£325,080
461699	27-Mar-1987	31-Dec-2045	163,500.10	9.000	£257,485
461700	27-Mar-1987	31-Dec-2046	196,200.12	9.000	£317,810
476645	30-Nov-1995	28-Jul-2053	163,500.10	8.000	£272,173
476646	30-Nov-1995	28-Jul-2054	163,500.10	8.000	£279,257
476647	30-Nov-1995	28-Jul-2055	163,500.10	8.000	£285,422
476842	21-Dec-1995	13-Dec-2052	163,500.10	7.875	£262,596
476843	21-Dec-1995	13-Dec-2051	163,500.10	7.875	£255,672
476844	21-Dec-1995	13-Dec-2050	163,500.10	7.875	£248,769
477672	05-Aug-1996	08-May-2048	163,500.10	8.375	£251,081
477673	05-Aug-1996	08-May-2049	163,500.10	8.375	£258,486
478210	26-Sep-1996	25-Sep-2047	217,138.76	8.125	£315,924
478211	26-Sep-1996	25-Sep-2056	163,500.10	8.125	£298,222
478214	26-Sep-1996	25-Sep-2047	28,111.39	8.125	£40,900
479404	21-May-1997	08-May-2057	327,000.20	7.125	£510,330
479405	21-May-1997	08-May-2056	147,150.09	7.125	£224,853
481709	13-Oct-1998	25-Sep-2058	163,500.10	4.625	£140,877
482002	14-Jan-1999	25-Sep-2058	320,460.20	4.375	£252,357
482386	30-Mar-1999	25-Mar-2059	23,271.98	4.625	£20,324
482875	08-Nov-1999	25-Mar-2059	163,500.10	4.500	£136,663
483562	18-Nov-1999	25-Sep-2059	163,500.10	4.250	£125,421
491043	19-Jan-2006	19-Jan-2034	465,521.00	4.000	£151,743
491501	05-Mar-2006	03-Nov-2051	2,689,694.00	4.400	£1,792,060
491580	19-May-2006	19-Nov-2046	1,303,000.00	4.250	£698,562
492151	20-Sep-2006	20-Mar-2052	1,856,434.00	4.200	£1,156,945
492927	19-Feb-2007	19-Aug-2052	2,000,000.00	4.400	£1,369,045
492928	19-Feb-2007	19-Aug-2053	2,000,000.00	4.400	£1,404,026
492929	19-Feb-2007	19-Aug-2054	1,427,410.00	4.400	£1,032,630
493087	03-Aug-2007	19-Aug-2052	2,500,000.00	4.250	£1,612,956
493088	03-Aug-2007	19-Aug-2053	2,000,000.00	4.250	£1,323,643
493089	03-Aug-2007	19-Aug-2054	1,414,351.00	4.250	£965,047
			21,386,323.30		**16,782,979**

Appendix D. - Economic Review (Provided by Capita)

1 ECONOMIC BACKGROUND REVIEW

1.1 UK. 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.

1.9 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.

1.10 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.

1.11 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.

1.12 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.

1.13 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.

1.14 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.

1.15 USA. 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.

1.16 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.

1.17 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.

1.18 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.

1.19 EZ. 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.

1.20 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.

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.

1.21 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.

1.22 Asia. 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.

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.

1.23 Emerging countries. 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.

1.24 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.

1.25 Brexit timetable and process

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.
- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.

- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.
- It is possible that some sort of agreement could be reached for a transitional time period for actually implementing Brexit after March 2019 so as to help exporters to adjust in both the EU and in the UK.

Appendix E. 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.

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.