Oldham Council

Report to Council

Treasury Management Strategy Statement 2016/17
Including Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators

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Reason for Decision

To present to Council the strategy for 2016/17 Treasury Management activities including the Minimum Revenue Provision Policy Statement, the Annual Investment Strategy and Prudential Indicators.

Executive Summary

The report outlines the Treasury Management Strategy for 2016/17 including Prudential Indicators and the Minimum Revenue Provision policy.

The Strategy for 2016/17 covers two main areas.

Capital Issues:

- The Capital Plans and the Prudential Indicators
- The Minimum Revenue Provision (MRP) Policy Statement

Treasury Management Issues:

- The Current Treasury Position
- Treasury Indicators for the three years 2016/17 to 2018/19
- Prospects for Interest Rates
- The Borrowing Requirement
- The Borrowing Strategy
- Policy on Borrowing in Advance of Need
- Debt Rescheduling
- The Investment Strategy
- Creditworthiness Policy
- Policy on use of external service providers.

The report therefore outlines the implications and key factors in relation to each of the above Capital and Treasury Management issues and makes recommendations with regard to the Treasury Management Strategy for 2016/17.

The Treasury Management Strategy was presented for scrutiny to the Overview and Scrutiny Performance and Value for Money Select Committee at its meeting on 21 January 2016. The Committee was content to commend the report to Cabinet without amendment who duly considered and approved the report at its meeting on 11 February and commended the report to Council.

Recommendations

Council is requested to approve the;

- Capital Financing Requirement (CFR) Projections as per paragraph 2.2.3
- MRP policy and method of calculation as per section 2.3
- Projected treasury portfolio position as at 31/03/2016 as per paragraph 2.5.3
- Treasury Limits for 2016/17 to 2018/19 as detailed in paragraphs 2.6.2 and 2.6.3
- Borrowing Strategy for 2016/17 as per section 2.9
- Limits to interest rate exposures as set out in section 2.10.2
- Upper and lower limits on fixed rate debt maturity structure as set out in section 2.10.3
- Annual Investment Strategy as per section 2.14 including the investment credit rating criteria and the level of investment in non-specified investments.

Council **24 February 2016**

Treasury Management Strategy Statement 2016/17 Including Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators

1 Background

1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low investment risk appetite, providing adequate liquidity initially before considering investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 Treasury management is defined as:

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

Statutory Requirements

1.4 The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Act therefore requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

CIPFA Requirements

1.5 The Council has adopted the Revised Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management 2011. The primary requirements of the code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's Treasury Management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an annual Treasury Management Strategy Statement (this report) – which includes:
  - the capital plans of the Council, including prudential indicators;
  - MRP Policy (how residual capital expenditure is charged to revenue over time);
  - the Treasury Management Strategy (how investments and borrowings are to be organised) including treasury indicators and an annual investment strategy (the parameters on how investments are to be managed).
- A Mid-Year Review Report, which updates Members with the progress of the capital position, amending prudential indicators as necessary and whether any policies require revision.
- An Annual Report, which provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.
- Delegation by the Council of responsibilities for implementing and monitoring Treasury Management Policies and Practices and for the execution and administration of treasury management decisions. In Oldham, this responsibility is delegated to the section 151 Officer (Director of Finance). The treasury management role of the Section 151 Officer is shown at Appendix 5.
- Delegation by the Council of the role of scrutiny of the Treasury Management Strategy and policies to a specific named body. In Oldham, the delegated body is the Audit Committee. The treasury management scheme of delegation is provided at Appendix 4.

Treasury Management Strategy 2016/17

1.6 The Strategy for 2016/17 covers two main areas.

1.6.1 Capital Issues

- The Capital Plans and the Prudential Indicators
- The Minimum Revenue Provision (MRP) Policy Statement

1.6.2 Treasury Management Issues

- The Current Treasury Position

- Treasury Indicators which limit the treasury risk and activities of the Council
- Prospects for Interest Rates
- The Borrowing Requirement
- The Borrowing Strategy
- Policy on Borrowing in Advance of Need
- Debt Rescheduling
- The Investment Strategy
- Creditworthiness Policy
- Policy on use of external service providers.

These elements are each addressed with the Treasury Management report.

Balanced Budget Requirement

1.7 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a Local Authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure; and
- any increases in running costs from new capital projects;

are limited to a level which is affordable and within the projected income of the Council for the foreseeable future.

Treasury Management Consultants

1.8 Oldham Council uses Capita Asset Services, Treasury Solutions as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon external service providers.

1.9 It is also recognised 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.

1.10 The contract engaging Capita Asset Services as the Council's Treasury Management advisors expired on 31 March 2015. The Council undertook a competitive joint tendering exercise with other Greater Manchester (GM) Local Government bodies to procure advisory services from April 2015. Capita Asset Services were re-appointed as Treasury Management advisors for a period of three years (with the option for a further year) effective from 1 April 2015.

Scrutiny of the Treasury Management Strategy

1.11 The Treasury Management Strategy was presented for scrutiny to the Overview and Scrutiny Performance and Value for Money Select Committee at its meeting on 21 January 2016. This provided Members of the Select Committee the opportunity to review the proposed Strategy and question the information and assumptions included in the report. The Committee was content to commend the report to Cabinet, who duly considered and approved the report at its meeting on 11 February and commended the report to Council.

2 Capital Plans and Prudential Indicators 2016/17 – 2018/19

2.1 Capital Plans

2.1.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans. These indicators as per the Capital Programme include previous years actual expenditure, forecast expenditure for the current year and estimates for the next three year period.

Capital Expenditure Estimates

2.1.2 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts in the table below:

Table 1 Capital Expenditure Estimates

Capital Expenditure	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Neighbourhoods	11,369				
Commissioning	1,306				
Commercial Services	16,426				
Regen and Development	31,859				
Deputy Chief Executive	100				
Cooperatives and Neighbourhoods		10,023	11,888	3,536	2,473
Corporate and Commercial Services		3,555	1,055	249	249
Economy and Skills		52,959	59,431	73,824	4,022
Health and Wellbeing		1,390	2,655	400	400
Funds yet to be allocated			5,402	0	0
General Fund Services	**61,060**	**67,927**	**80,431**	**78,009**	**7,144**
HRA	5,791	405	114	0	0
HRA	**5,791**	**405**	**114**	**0**	**0**
Total	**66,851**	**68,332**	**80,545**	**78,009**	**7,144**

*** 2014/15 actuals are stated in the old portfolio arrangements; services were realigned for the 2015/16 financial year*

2.1.3 The capital expenditure shown above excludes other long term liabilities, such as Private Finance Initiatives (PFI) and leasing arrangements which already include borrowing instruments. It should be noted that new expenditure commitments are likely to increase the borrowing requirement.

2.1.4 Table 2 below summarises the above capital expenditure plans and how these plans are being financed. Any shortfall of resources results in a funding need (borrowing).

2.1.5 The borrowing need for 2016/17 is £36.510m. This will change if there is a revision to the spending profile of the capital programme. Some of the expected borrowing will be supported by new income streams and a further tranche is underwriting expected grants and contributions. If spending plans change there may not be a requirement to borrow.

Table 2 Funding of the Capital Programme

Capital Expenditure	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
General Fund Services	61,060	67,927	80,431	78,009	7,144
HRA	5,791	405	114	0	0
Total	66,851	68,332	80,545	78,009	7,144
Financed by:					
Capital receipts	(4,097)	(6,793)	(12,099)	(5,890)	(6,232)
Capital grants	(18,224)	(27,772)	(24,785)	(29,246)	(1,973)
Revenue	(12,124)	(926)	(4,605)		
HRA	(5,791)	(405)	(2,547)	(4,867)	0
Net financing need for the year	**26,615**	**32,436**	**36,510**	**38,006**	**(1,061)**

2.1.6 All other performance indicators included within this report are based on the above capital estimates.

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

2.2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

2.2.2 The CFR does not increase indefinitely, as both MRP, which is a statutory annual revenue charge, and voluntary revenue provision (VRP) both act to broadly reduce the borrowing need in line with each assets life.

2.2.3 The CFR includes other long term liabilities (e.g. PFI schemes, finance leases etc.). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £278.54m of such schemes within the CFR, decreasing to £272.97m in 2016/17.

Table 3 Capital Financing Requirement (CFR)

	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Capital Financing Requirement					
CFR	527,364	543,243	558,377	574,890	549,396
CFR - housing					
Total CFR	**527,364**	**543,243**	**558,377**	**574,890**	**549,396**
Movement in CFR	47,492	15,879	15,134	16,513	(25,494)
Movement in CFR represented by					
Net financing need for the year	26,615	32,436	36,511	38,006	(1,061)
PFI Additions	39,221	3,738	0	0	0
Less MRP/VRP and other financing movements	(18,343)	(20,296)	(21,378)	(21,494)	(24,433)
Movement in CFR	47,493	15,878	15,133	16,512	(25,494)

2.3 MRP Policy Statement

2.3.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the MRP) to the income and expenditure account. The Council is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

2.3.2 Department for Communities and Local Government (DCLG) regulations require the full MRP Statement to be decided upon in advance of each year and reported to Council. The Council has to ensure that the chosen options are prudent.

2.3.3 For capital expenditure incurred before 1 April 2008, or which in the future will be Supported Capital Expenditure, the MRP policy will follow existing practice outlined in former DCLG regulations. This sets aside 4% each year of the Council's CFR less an adjustment for changes to regulations. This historic approach will continue for all capital expenditure incurred in the years before the change was introduced. The Council may from time to time wish to review the MRP policy in relation to historic debt and in particular to ensure the rates and method of calculation employed remain appropriate.

2.3.4 From 1 April 2008 for all unsupported borrowing, referred to as prudential borrowing, the MRP policy will be the Asset Life Method. MRP will be based on the estimated life of the assets, in accordance with the regulations issued by DCLG. The calculation of the provision will either be the annuity method or equal

instalments method depending on which is most appropriate. Furthermore, where appropriate provision for MRP will commence upon the completion of assets rather than when expenditure is incurred.

2.3.5 Repayments included in annual PFI or finance leases are applied as MRP.

2.3.6 The Council currently operates a Local Authority Mortgage Scheme (LAMS) using the cash backed option. The mortgage lenders require a five year deposit from the Local Authority to match the five year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending and is treated as capital expenditure and a loan to a third party. The CFR will increase by the amount of the total indemnity. The cash advance is due to be returned in full at maturity, with interest paid annually. Once the cash advance matures and funds are returned to the Local Authority, the returned funds are classed as a capital receipt, which will be applied to reduce the CFR. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

2.4 Affordability Prudential Indicators

2.4.1 The previous sections cover the overall capital programme 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.

a) Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this report.

Table 4 Ratio of Net Financing Cost to Net Revenue Stream

	2014/15 Actual	2015/16 Forecast	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
General Fund excluding DSG*	14.90%	13.64%	16.31%	19.21%	21.15%

* Dedicated School Grant (DSG)

Table 4 above includes financing costs in relation to PFI schemes, for which the Council receives PFI grant direct from Central Government and therefore the above figures would reduce with the exclusion of PFI income and expenditure i.e. the Council's financing costs requiring funding from the council tax base.

b) Incremental impact of new capital investment decisions on council tax

Table 5 identifies the revenue costs associated with proposed changes to the capital programme recommended in the report for 2016/17 compared to the

Council's existing approved commitments and current plans. The indicators in tables 4 and 5 are based on the current budget, but will invariably include some estimates and will change with any variation in the profile of expenditure.

Table 5 Incremental Impact of New Capital Investment Decisions on Band D Council Tax

	2014/15 Actual	2015/16 Forecast	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Increase in council tax (Band D)	£25.23	£44.25	£51.75	£55.77	£57.41

2.4.2 The above calculation is based on Band D equivalent properties, using the approved tax base for 2016/17 of 54,406 properties.

2.5 Borrowing

2.5.1 The capital expenditure plans set out in section 2.1 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury and prudential indicators, the current and projected debt positions and the annual investment strategy.

Current Portfolio Position

2.5.2 The Council's treasury portfolio position at 31 March 2016, with forward projections, is summarised below. Table 6 shows the actual external debt (the treasury management operations), against the underlying capital borrowing need, the CFR, highlighting any over or under borrowing.

2.5.3 Table 6 shows the forecast position of gross borrowing as at 31 March 2016 being £443.084m and an under-borrowed position of £100.159m.

Table 6 Current & Forecast Treasury Portfolio

	2014/15 Actual £'000	Forecast Position as at 31/3/16 £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
External Debt					
Debt @ 1st April	148,117	148,117	175,617	219,117	254,117
Expected change in debt	(0)	22,000	44,000	43,500	20,000
Other long-term liabilities	248,003	278,543	272,968	264,054	256,040
Expected change in OLTL*	30,540	(5,575)	(8,914)	(7,645)	(9,743)
Actual Gross Debt at 31 March	**426,660**	**443,084**	**478,170**	**514,026**	**524,283**
The Capital Financing Requirement	**527,364**	**543,243**	**558,377**	**574,890**	**549,396**
Under-Borrowing	**100,704**	**100,159**	**80,206**	**60,864**	**25,114**

** (OTL) - Other Long Term Liabilities*

2.5.4 Table 6 above shows the Council will need to take out significant borrowings in future years if the capital programme spends in accordance with the anticipated profile. The borrowing requirement is a key influence over the borrowing strategy as set out in section 2.9. However, the Council has not yet needed to take out additional borrowing and the timing of the borrowing is being closely monitored.

2.5.5 There are a number of key prudential indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. It is clear from the table above that the Council's gross borrowing position remains within these limits.

2.5.6 The Council has complied with this prudential indicator in the current year and does not envisage difficulties in the future. This view takes into account current commitments, existing plans and the proposals in this report.

2.6 Treasury Limits for 2016/17 to 2018/19

2.6.1 The Council is required to determine its operational boundary and authorised limit for external debt for the next three years.

Operational Boundary

2.6.2 The forecast operational boundary for 2015/16 together with the proposed operational boundaries for 2016/17 to 2018/19 are set out in Table 7 below. The boundary reflects the maximum anticipated level of external debt consistent with budgets and forecast cash flows, and the CFR. This boundary will be used as a management tool for ongoing monitoring of external debt and may be breached

temporarily due to unusual cash flow movements. However a sustained or regular trend above the operational boundary should trigger a review of both the operational boundary and the authorised limit.

Table 7 Operational Boundary

Operational Boundary £'000	2015/16 Forecast	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Borrowing	285,000	310,000	330,000	315,000
Other long term liabilities	275,000	265,000	255,000	245,000
Total	**560,000**	**575,000**	**585,000**	**560,000**

Authorised Limit

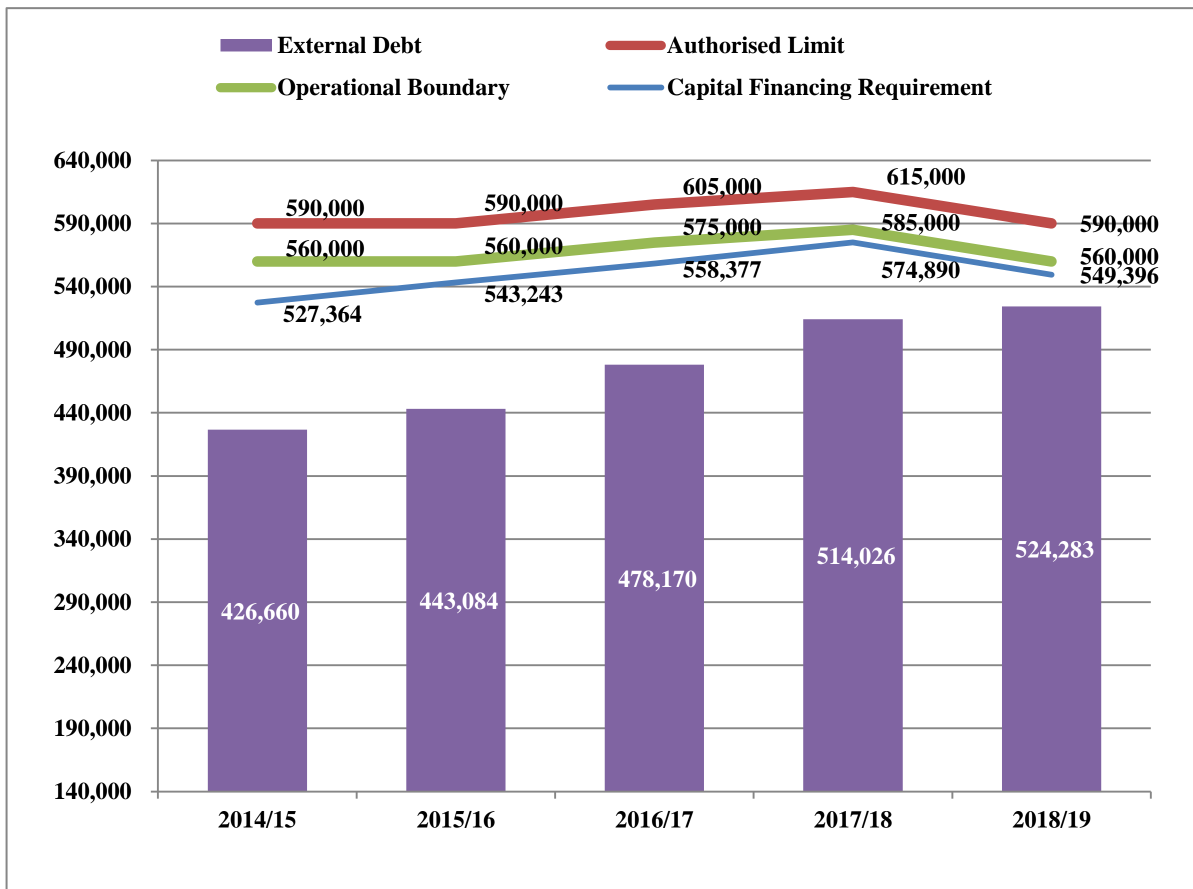
2.6.3 A further key prudential indicator, the Authorised limit, represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. 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 this power has not yet been exercised. The Authorised Limit is set out in Table 8 below.

Table 8 Authorised Limit

Authorised Limit £'000	2015/16 Forecast	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Borrowing	305,000	330,000	350,000	335,000
Other long term liabilities	285,000	275,000	265,000	255,000
Total	**590,000**	**605,000**	**615,000**	**590,000**

2.6.4 The following graph shows how graphically the two indicators above, the Operational Boundary and the Authorised Limit, compare to actual external debt and the CFR.

Graph 1 External Debt and the Authorised Limit



2.7 Prospects for Interest Rates

2.7.1 The Council has appointed Capita Asset Services as its Treasury Advisor and part of its service is to assist the Council to formulate a view on interest rates. Appendices 1 and 2 draw together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table and narrative gives the Capita Asset Services view to March 2019.

Table 9 Interest Rate Forecast

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate reduction)			
		5 year	10 year	25 year	50 year
Mar-16	0.50	2.00	2.60	3.40	3.20
Jun-16	0.50	2.10	2.70	3.40	3.20
Sep-16	0.50	2.20	2.80	3.50	3.30
Dec-16	0.75	2.30	2.90	3.60	3.40
Mar-17	0.75	2.40	3.00	3.70	3.50
Jun-17	1.00	2.50	3.10	3.70	3.60
Sep-17	1.00	2.60	3.20	3.80	3.70
Dec-17	1.25	2.70	3.30	3.90	3.80
Mar-18	1.25	2.80	3.40	4.00	3.90
Jun-18	1.50	2.90	3.50	4.00	3.90
Sep-18	1.50	3.00	3.60	4.10	4.00
Dec-18	1.75	3.10	3.60	4.10	4.00
Mar-19	1.75	3.20	3.70	4.10	4.00

United Kingdom (UK)

2.7.2 UK Gross Domestic Product (GDP) growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any Group 7 (G7) country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%.

2.7.3 Quarter 1 of 2015 was weak at 0.4% (2.9% annualised) though there was a rebound in quarter 2 to 0.5% (2.3% annualised) before weakening again to 0.4% (2.1% annualised) in quarter 3.

2.7.4 The November 2015 Bank of England Inflation Report included a forecast for growth to remain around 2.5% to 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that Consumer Price Index (CPI) inflation has fallen to, or near to, zero since February 2015.

2.7.5 Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK.

2.7.6 The Inflation Report was notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015,

will fall out of the 12 month calculation of CPI during late 2015 / early 2016. A second, more recent round of falls in commodity prices will delay a significanat tick up in inflation from around zero: this is now expected to get back to around 1% by the end of 2016 and not get to near 2% until the second half of 2017, though the forecasts in the report itself were for an even slower rate of increase.

2.7.7 More falls in the price of oil and imports from emerging countries in early 2016 will further delay the pick up in inflation. There is therefore considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the Bank of England Monetary Policy Committee (MPC) will decide to make a start on increasing the Bank Rate.

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

USA

2.7.9 The American economy made a strong comeback after a weak first quarter's growth at 0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then weakened again to 2% in quarter 3.

2.7.10 The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 prepared the way for the Federal Reserve (Fed) to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

Eurozone

2.7.11 In the Eurozone (EZ), the European Central Bank (ECB) made a major statement in January 2015 by launching a €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016.

2.7.12 At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from a negative 0.2% to a negative 0.3%.

2.7.13 This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% annualised) but has then eased back to 0.4% (1.6% annualised) in quarter 2 and to 0.3% (1.6% annualised) in quarter 3.

2.7.14 Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its quantitaive easing (QE) programme

if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece

2.7.15 During July, Greece finally yielded to European Union (EU) demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did little to address the unsupportable size of total debt compared to GDP.

2.7.16 However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January 2015, to EU demands. The surprise general election in September 2015 gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

Potugal and Spain

2.7.17 The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats.

2.7.18 An anti-austerity coalition has won a majority of seats in Portugal while the general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats.

2.7.19 It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

General Interest Rate Forecasts

2.7.20 In overall terms:

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically very low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later years, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to re-finance maturing debt;
- There will remain a “cost of carry” to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

2.8 Public Works Loan Board (PWLB) Rates

2.8.1 PWLB rates are expected to gradually increase during the year 2016 and continue to do so for the next three years. Rates on loans of less than ten years duration are expected to be substantially lower than longer term PWLB rates, thereby offering a range of options for new borrowing which will spread debt maturities away from a concentration in long dated debt. There is likely to be little or no difference between 25 year and 50 year rates thus loans in the 25-30 year periods could be seen as being more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less.

2.9 Borrowing Strategy

2.9.1 The factors that influence the 2016/17 Strategy are:

- The movement in CFR as per Table 3
- Impending option dates on £59m of Lender Option Borrower Option loans (LOBO's) in 2016/17
- Interest rate forecasts as per Table 9
- The aim of minimising revenue costs to reduce the impact on Council Tax.
- The impact of the Council's Investment Programme

2.9.2 The Council is currently maintaining an under-borrowed position. This means that the CFR has not been fully-funded with loan debt because cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high, however as interest rates are low, consideration will be given to taking advantage of this by securing fixed rate funding and reducing the under borrowed position.

2.9.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Treasury Management team will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances so that:

- If it was considered that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- If it was considered that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

2.9.4 The gross borrowing requirement in Table 6 shows, based on current estimates, that the Council will need to take out a significant amount of new borrowings, to support the capital programme. Any new borrowing taken out will be completed with regard to the limits, indicators and interest rate forecasts set out above.

2.9.5 During 2016/17, £59m of LOBO (Lender Option Borrower Option) debt will reach the option renewal date. Table 11 sets out the maturity structure of fixed rate debt. At the renewal date the loans will either:

- Move to the option rate of interest, which in all cases will be the same as the current rate, or

- Be offered at a rate above the option rate, in which case the Council has the option to repay. This would then require re-financing at the prevailing market rates. Based on current interest rates it is not anticipated that these loans will require re-financing.

2.9.6 The 2015/16 capital programme now shows anticipated prudential borrowing of £32.436m with £36.510m in 2016/17 and £38.006m in 2017/18. These figures have been reflected in this report and factored into the borrowing strategy for 2016/17 and future years.

2.10 Treasury Management Prudential Indicators – Limits on Activity

2.10.1 There are three debt-related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs and, or improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for re-financing, and are required for upper and lower limits.

2.10.2 Table 10 sets out the limits on interest rate exposures:

Table 10 Limits on Interest Rate Exposures

	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
Upper Limit on Fixed Interest Rate Exposure	100%	100%	100%	100%
Upper Limit on Variable Interest Rate Exposure	30%	30%	30%	30%

2.10.3 Table 11 below sets out the proposed upper and lower limits on maturity structure of fixed rate debt, for 2016/17. The maturity structure guidance for LOBOs changed in the 2011 guidance notes; the call date is now deemed to be the maturity date. LOBO's are classed as fixed rate debt until the call date. Within the next 12 months (2016/17) up to 47% of LOBO debt will reach its call date, however it is not anticipated that these loans will be called by the lending institutions and require refinancing.

Table 11 Upper and Lower Limits on Maturity Structure of Fixed Rate Debt

Maturity Structure of Fixed Interest Rate Debt	2016/17 Upper Limit	Lower Limit
Under 12 months	50%	0%
12 months and within 24 months	7%	0%
24 months and within 5 years	28%	0%
5 years and within 10 years	5%	0%
10 years and above	10%	40%

2.11 Policy on Borrowing in Advance of Need

2.11.1 The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

2.11.2 Borrowing in advance will be made within the constraint that the Council would not look to borrow more than 24 months in advance of need.

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

2.12 Debt Rescheduling

2.12.1 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

2.12.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings and/ or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility)
- to participate in the refinancing of PFI and PPP type agreements in either equity share or bank funded debt where it is considered be financially and/or operationally advantageous for the Council.

2.12.3 Consideration will also be given to identifying if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

2.12.4 All re-scheduling will be reported to Cabinet and Council at the earliest meeting following its action.

2.13 Local Capital Finance Company (originally Municipal Bond Agency)

2.13.1 It is likely that Local Capital Finance Company, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB).

2.13.2 The Council has currently invested £100k in the Company and intends to make use of this new source of borrowing as and when appropriate.

2.14 Annual Investment Strategy

Changes to Investment Credit Rating Methodology

2.14.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level.

2.14.2 The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed.

2.14.3 A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

2.14.4 In keeping with the agencies' new methodologies, the rating element of the Council's own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

2.14.5 The evolving regulatory environment, in tandem with the rating agencies' new methodologies, also means that sovereign ratings are now of lesser importance in the assessment process. Where, throughout the banking crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions.

2.14.6 While this Council understands the changes that have taken place, it will continue to specify a minimum non-UK sovereign rating of AAA. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

2.14.7 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate.

2.14.8 While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit-worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign Government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support.

2.14.9 In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

Investment Policy

2.14.10 The Council's investment policy has regard to the Department for Communities and Local Government (DCLG's) Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:

- firstly, the security of capital
- secondly, the liquidity of its investments

- thirdly, the optimum return on its investments commensurate with proper levels of security and liquidity
- finally, ethical Investments.

2.14.11 In accordance with the above guidance from the DCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoids risk concentration. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

2.14.12 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings

2.14.13 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counetrparties.

2.14.14 Investment instruments identified for use in the financial year are detailed below under the ‘specified’ and ‘non-specified’ investments categories.

Specified Investments

2.14.15 The table below sets out the specified investments. These are sterling denominated with maturities up to a maximum of 1 year, meeting the minimum ‘high’ rating criteria where applicable.

Table 12 Specified Investments

Type of Investment	Minimum Credit Criteria / Colour Band	Max. Maturity Period
Debt Management Account Deposit Fund – UK Government (Debt Management Office)	N/A	6 months
UK Government gilts	UK sovereign rating	1 year
UK Government Treasury bills	UK sovereign rating	1 year
Bonds issued by multilateral development banks	AA	1 year
Money market funds	AAA	Liquid
Enhanced money market funds	AAA	Liquid
Public Sector Bodies	N/A	1 year
Term deposits with banks and building societies	Blue Orange Red Green No Colour	1 year 1 year 6 Months 100 days Not for use
Certificates of Deposit and/ or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	1 year 1 year 6 Months 100 days Not for use
Corporate bond funds	AA	1 year
Gilt funds	UK sovereign rating	1 year

Non-Specified Investments

2.14.16 The table below lists some of the non-specified investments. These are investments which do not meet the specified investment criteria detailed above in Table 12.

Table 13 Non-Specified Investments

Type of Investment	Minimum credit criteria / colour band	Max. maturity period
UK Government gilts	UK sovereign rating	2 years
UK Government Treasury bills	UK sovereign rating	2 years
Public Sector Bodies	N/A	5 years
Bonds issued by multilateral development banks	AAA	3 years
Term deposits with banks and building societies	Yellow Purple No Colour	5 years 2 years Not for use
Certificates of Deposit and/ or corporate bonds with banks and building societies	Yellow Purple No Colour	5 years 2 years Not for use
Corporate bond funds	AAA	3 years
Gilt funds	UK sovereign rating	2 year
Municipal Bonds Agency	N/A	N/A
Property funds	N/A	5 Years

2.14.17 As highlighted above (paragraph 2.3.6), the Council participates in the Local Authority Mortgage Scheme. Under this scheme the Council has placed funds of £2m, with Lloyds TSB, for a period of 5 years. This is classed as being a service investment rather than a treasury management investment and is also outside the specified / non specified categories.

2.14.18 The Council will keep under review the availability of alternative investment products that satisfy the Treasury Management investment criteria, being particularly aware of a Local Authority backed “Local Government Investment Fund” that will shortly be coming to the market.

2.15 Creditworthiness Policy

2.15.1 Oldham Council applies the creditworthiness service provided by Capita Asset Services Treasury Advisors. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poor. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries.

2.15.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments.

2.15.3 Institutions are split into colour bandings and the Council will therefore use counterparties within these colours, durational bands and investment limits. Table 14 below shows these limits.

Table 14 Investment Criteria

Capital Colour Band	Maximum Duration	Maximum Principal Invested £
Yellow (Note 1)	5 Years	£10m
Dark Pink (Note 2)	5 Years	£10m
Light Pink (Note 3)	5 Years	£10m
Purple	2 Years	£20m
Blue (Note 4)	1 Year	£20m
Orange (Note 5)	1 Year	£15m
Red	6 months	£10m
Green	100 days	£10m
No Colour	Not to be used	Not to be used

Note 1 – Includes Public Sector Bodies

Note 2 – Enhanced money market funds (EMMF) with a credit score of 1.25

Note 3 - Enhanced money market funds (EMMF) with a credit score of 1.5

Note 4 – Blue Institutions only applies to nationalised or semi nationalised UK Banks, which are currently:

- RBS Group – Royal Bank of Scotland
- NatWest Bank
- Ulster Bank.

Note 5 - Includes the Council's banking provider (currently Barclays), if it currently falls into category below this colour band.

2.15.4 The Capita Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

2.15.5 Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

2.15.6 All credit ratings will be monitored on a daily basis. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Sevices Treasury Advisory creditworthiness service.

- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn or notice given to withdraw immediately.

- In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

2.15.7 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on any external support banks to help support its decision making process.

2.16 Country and Sector Limits

2.16.1 It is not proposed to restrict the Council's investment policy to only UK banks and building societies, however in addition to the credit rating criteria set out above consideration will be given to the sovereign rating of the country before any investment is made.

2.16.2 In February 2013 the UK lost its AAA rating and moved to an AA+ rating. The Council will continue to invest with UK Banks, providing the individual institutions still meet the relevant criteria

2.16.3 The Council has determined that it will only use approved counterparties from non-UK countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 3. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy, therefore for illustrative purposes the appended list is extended to also show AA+ i.e. the countries currently assesed to be in the rating below those that currently qualify.

2.17 Investment Strategy

2.17.1 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). The Council currently has investments totalling £42.0m which span the financial year as shown in Table 15. These investments are either current as at February 2016 or forward deals that commence in the new financial year 2016/17.

Table 15 Investments Maturing in 2016/17

Counterparty	Amount	Maturity Date	Rate
Nationwide	£2,500,000	14/04/2016	0.66%
RBS	£5,000,000	15/04/2016	0.91%
Standard Chartered	£5,000,000	20/04/2016	0.73%
Standard Chartered	£2,500,000	04/05/2016	0.90%
Bank of Scotland	£3,000,000	09/05/2016	0.75%
Bank of Scotland	£5,000,000	18/05/2016	0.75%
Barclays	£3,000,000	20/05/2016	0.85%
Santander	£2,500,000	03/06/2016	0.71%
RBS	£3,000,000	12/07/2016	0.95%
Barclays	£3,000,000	25/11/2016	0.97%
Herefordshire Council	£7,500,000	23/12/2016	0.70%
Total	**£42,000,000**		

2.17.2 The Bank Rate is forecast to remain unchanged at 0.50% before starting to rise from quarter 3 of 2016/17. Bank rates forecasts for financial year ends are:

- 2016/17 0.75%
- 2017/18 1.25%
- 2018/19 1.75%

2.17.3 There are downside risks to these forecasts (i.e. the start of increases in the Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken or forecasts for increases in inflation rise, there could be an upside risk.

2.17.4 The Council looks to achieve a return on its investment greater than the London Interbank Bid Rate (LIBID). It will benchmark investment returns matched to the relevant period of investment, 7 day LIBID and 3, 6 & 12 month LIBID multiplied by 5%. Forecast LIBID rates can be seen in Appendix 1.

2.17.5 The Council will maintain sufficient cash reserves to give it its necessary liquidity and may place investments for up to 5 years if the cash flow forecast allows and the credit rating criteria is met.

2.17.6 The Council will avoid locking into longer term deals i.e., “more than 364 days” while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by the Council.

2.17.7 For daily cash management, the Council will seek to utilise its business reserve instant access accounts, 15 and 30 day accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

Investment Treasury Indicator and Limit

2.17.8 This indicator looks at 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 investment, and are based on the availability of funds after each year end.

Table 16 Maximum Principal Sum Invested Greater Than 364 days

	2016/17	2017/18	2018/19
Principal sums invested > 364 days	£20m	£20m	£20m

2.18 Investment Risk Benchmarking

2.18.1 These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft facility £2m (currently being reviewed)
- Liquid short term deposits of at least £10m available with a week’s notice.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate multiplied by 5%
- Investments – internal returns above the 1 month LIBID rate multiplied by 5%
- Investments – internal returns above the 3 month LIBID rate multiplied by 5%
- Investments – internal returns above the 6 month LIBID rate multiplied by 5%
- Investments – internal returns above the 12 month LIBID rate multiplied by 5%

2.18.2 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report, which is in accordance with required practice and is presented to Council and Cabinet for approval and the Audit Committee for scrutiny.

2.19 Prepayment Discounts

2.19.1 The Council will seek to maximise its treasury position by taking advantage of any discounts on payments made or managed by the Treasury Management team, subject to the usual rigorous due diligence and having regard to an appropriate risk assessment, counterparty review and contractual obligations

3 Options/Alternatives

3.1 In order that the Council complies with the CIPFA Code of Practice on Treasury Management, the Council has no option other than to consider and approve the contents of the report. Therefore no options/alternatives have been presented. The role of Cabinet is to approve the proposed Treasury Management Strategy to ensure that the document that the Council is approving is robust and enables the financial position of the Council to be safeguarded.

4 Preferred Option

4.1 The preferred option is that the contents of the report are approved by Council..

5 Consultation

5.1 There has been consultation with Capita Asset Services, Treasury Management Advisors. The presentation to the PVFM Select Committee on 21 January 2016 was a key stage in the consultation process, following which the report was considered and approved at the 11th February Cabinet meeting.

6 Financial Implications

6.1 All included in the report.

7 Legal Services Comments

7.1 None

8 Cooperative Agenda

8.1 The treasury management strategy embraces the Council's cooperative agenda. The Council will develop its investment framework to ensure it complements the cooperative ethos of the Council.

9 Human Resources Comments

9.1 None

10 Risk Assessments

10.1 There are considerable risks to the security of the Authority's resources if appropriate treasury management strategies and policies are not adopted and followed. The Council has established good practice in relation to treasury management which have previously been acknowledged in the External Auditors' Annual Governance Report presented to the Audit Committee.

11 **IT Implications**

11.1 None

12 **Property Implications**

12.1 None

13 **Procurement Implications**

13.1 None

14 **Environmental and Health & Safety Implications**

14.1 None

15 **Equality, community cohesion and crime implications**

15.1 None

16 **Equality Impact Assessment Completed?**

16.1 No

17 **Key Decision**

17.1 Yes

18 **Key Decision Reference**

18.1 CFHR-29-15

19 **Background Papers**

19.1 The following is a list of background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents which would disclose exempt or confidential information as defined by the Act:

File Ref: Background papers are provided in Appendices 1 - 6
Officer Name: Anne Ryans
Contact No: 0161 770 4902

20 **Appendices**

Appendix 1	Capita Asset Services - Treasury Advisor's Interest Rate Forecast 2016-19
Appendix 2	Economic Background
Appendix 3	Approved Countries for Investments

Appendix 4	Treasury Management Scheme of Delegation
Appendix 5	Treasury Management Role of the Section 151 Officer
Appendix 6	Treasury Management Indicators

APPENDIX 1 – CAPITA ASSET SERVICES INTEREST RATE FORECAST 2016 – 2019

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Capita Asset Services Interest Rate View													
	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%
6 Month LIBID	0.70%	0.70%	0.80%	0.90%	1.00%	1.20%	1.30%	1.50%	1.60%	1.70%	1.80%	2.00%	2.20%
12 Month LIBID	1.00%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.80%	1.90%	2.00%	2.10%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB Rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB Rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
Capital Economics	0.50%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
Capital Economics	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
Capital Economics	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

APPENDIX 2 - ECONOMIC BACKGROUND

United Kingdom

UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 2015 was weak at 0.4% (2.9% annualised), although there was a slight increase in quarter 2 to 0.5% before weakening again to 0.4% (2.1% annualised) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% to 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.1%.

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

- Quarter-on-quarter GDP growth is above 0.6% i.e. using up spare capacity. This condition was met in quarter 2 2015, but quarter 3 came up short and quarter 4 looks likely to also fall short.
- Core inflation (stripping out most of the effect of decreases in oil prices), registers a concerted increase towards the MPC's 2% target. This measure was on a steadily decreasing trend since mid-2014 until November 2015 registered at 1.2%. December 2015 saw a further slight increase to 1.4%.
- Unit wage costs are on a significant increasing trend. This would imply that spare capacity for increases in employment and productivity gains are being exhausted, and that further economic growth will fuel inflationary pressures.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. However, it is unlikely that the MPC would start raising rates until wage inflation was expected to consistently stay over 3%, as a labour productivity growth rate of around 2% would mean that net labour unit costs would still only be rising by about 1% year on year. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. However, the first round of falls in oil, gas and food prices in late 2014 and in the first half of 2015, will fall out of the 12 month calculation of CPI during late 2015 and early 2016 but only to be followed by a second, subsequent round of falls in fuel and commodity prices which will delay a significant tick up in inflation from around zero. CPI inflation is now expected to get back to around 1% in the second half of 2016 and not get near to 2% until

the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase.

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

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

There is, therefore, considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left open to them given that central rates are near to zero and huge QE is already in place. There are, accordingly, arguments that rates ought to rise sooner and quicker, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would aggressively raise rates until they are sure that growth was securely embedded and ‘noflation’ was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively over the last year from quarter 4 2015 to quarter 4 2016. Increases after that are also likely to be at a much slower pace, and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008. There has also been an increase in momentum towards holding a referendum on membership of the EU in 2016, rather than in 2017, with quarter 3 2016 being the current front runner in terms of timing; this could impact on MPC considerations to hold off from a first increase until the uncertainty caused by it has passed.

The Government’s revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

USA
GDP growth in 2014 of 2.4% was followed by quarter 1 2015 growth, which was depressed by exceptionally bad winter weather, at only 0.6% (annualised). However, growth rebounded remarkably strongly in quarter 2 to 3.9% (annualised) before falling back to 2.0% in quarter 3.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed would start to increase rates in September. The Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong while November was also reasonably strong and December was outstanding; this, therefore, opened up the way for the Fed to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

Eurozone
The ECB in January 2015 embarked on a €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from a negative 0.2% to a negative 0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% year on year) but has then eased back to 0.4% (1.6% year on year) in quarter 2 and to 0.3% (1.6% year on year) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece
During July Greece finally yielded to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did little to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the initial resistance of the Syriza Government, elected in January 2015, to EU demands. The surprise general election in September 2015 gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain
The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. A left wing / communist anti-

austerity coalition has won a majority of seats in Portugal. The general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

China and Japan

Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In quarter 2 2015 quarterly growth shrank by a negative 0.2% after a short burst of strong growth of 1.1% during quarter 1, but then came back to appositive 0.3% in quarter 3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Abe government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already had two attempts at reform and has delayed implementing the third available option; deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 and the start of 2016 in implementing several stimulus measures to try to ensure the economy hits the growth target of about 7% for 2015. It has also sought to bring some stability after the major fall in the onshore Chinese stock market during the summer and then a second bout in January 2016. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure of which the EU would be envious. Nevertheless, there are growing concerns about whether the Chinese economy could be heading for a hard landing and weak progress in rebalancing the economy from an over dependency on manufacturing and investment to consumer demand led services. There are also concerns over the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September and again in January 2016, which could lead to a flight to quality bond markets. In addition, the international value of the Chinese currency has been on a steady trend of weakening and this will put further downward pressure on the currencies of emerging countries dependent for earnings on exports of their commodities.

Emerging Countries

There are also considerable concerns about the vulnerability of some emerging countries, and their corporates, which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis, (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries), there is now a strong flow back to those western economies with strong growth and a path of rising interest rates and bond yields.

The currencies of emerging countries have therefore been depressed by both this change in investors' strategy, and the consequent massive reverse cash flow, and also by the expectations of a series of central interest rate increases in the US which has caused the dollar to appreciate significantly. In turn, this has made it much more costly for emerging

countries to service their dollar denominated debt at a time when their earnings from commodities are depressed by a simultaneous downturn in demand for their exports and deterioration in the value of their currencies. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Capita Asset Services undertook its last review of interest rate forecasts on 19 January 2016. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 4 of 2016.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. At some future point in time, an increase in investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently to the downside, given the number of potential headwinds that could be growing on both the international and UK scene. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in January 2016, (based on short sterling), for the first Bank Rate increase are currently around quarter 1 2017.

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

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

- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

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

- Uncertainty around the risk of a UK exit from the EU. The pace and timing of increases in the Fed funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

APPENDIX 3 - APPROVED COUNTRIES FOR INVESTMENTS

As at February 2016

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.K.
- U.S.A.

APPENDIX 4 - TREASURY MANAGEMENT SCHEME OF DELEGATION

The scheme of delegation is as follows.

Full Council is the responsible body for:

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations.

Cabinet is the responsible body for:

- reviewing the treasury management reports, strategies, policies and procedures and making recommendations to the responsible body.

Audit Committee is responsible for:

- scrutiny of the treasury management reports, strategies, policies and procedures and making recommendations to the responsible body.

Cabinet Member for Finance and HR is responsible for:

- approving the selection of external service providers and agreeing terms of appointment.

APPENDIX 5 - TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER (DIRECTOR OF FINANCE)

The Section 151 (responsible) officer will discharge the treasury management role by:

- recommending clauses, treasury management policy/practices for approval
- reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit with regard to treasury matters
- recommending the appointment of external service providers.

APPENDIX 6 - TREASURY MANAGEMENT INDICATORS

TABLE 1 Prudential Indicators	2014/15 Actual £'000	2015/16 Probable Out-Turn £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Capital Expenditure					
General Fund	61,060	67,927	80,431	78,009	7,144
HRA	5,791	405	114	0	0
TOTAL	**66,851**	**68,332**	**80,545**	**78,009**	**7,144**
In year Capital Financing Requirement (Including Long Term Liabilities)					
General Fund	47,492	15,879	15,134	16,513	(25,494)
Capital Financing Requirement at 31 March (Including Long Term Liabilities)					
General Fund	527,364	543,243	558,377	574,890	549,396
Borrowing Requirement	0	22,000	44,000	43,500	20,000
Ratio of Financing Costs to Net Revenue Stream					
General Fund	14.90%	13.64%	16.31%	19.21%	21.15%
Incremental Impact of Capital Investment Decisions	£ p	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	25.23	44.25	51.75	55.77	57.41

TABLE 2 Treasury Management Indicators	2014/15 Actual £'000	2015/16 Probable Out-Turn £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Operational Boundary for External Debt					
Borrowing		285,000	310,000	330,000	315,000
Other long term liabilities		275,000	265,000	255,000	245,000
TOTAL		**560,000**	**575,000**	**585,000**	**560,000**
Authorised Limit for External Debt -					
Borrowing		305,000	330,000	350,000	335,000
Other long term liabilities		285,000	275,000	265,000	255,000
TOTAL		**590,000**	**605,000**	**615,000**	**590,000**
Actual External Debt	426,660				
Upper Limit on Fixed Interest Rate Exposure		100%	100%	100%	100%
Upper Limit on Variable Interest Rate Exposure		30%	30%	30%	30%
Upper Limit for Total Principal Sums Invested for Over 364 days		20,000	20,000	20,000	20,000

TABLE 3 Maturity Structure of New Fixed Rate Borrowing During 2015/16	Upper Limit	Lower Limit
Under 12 months	50%	0%
12 months and within 24 months	7%	0%
24 months and within 5 years	28%	0%
5 years and within 10 years	5%	0%
10 years and above	10%	40%