BODY:	**CABINET**
DATE:	**4 February 2015**
SUBJECT:	**Treasury Management and Prudential Indicators 2015/16**
REPORT OF:	**Chief Finance Officer**

Ward(s):	All
Purpose:	To approve the Council's Annual Treasury Management Strategy together with the Treasury and Prudential Indicators for the next financial year.
Decision Type	Key decision
Contact:	Alan Osborne, Chief Finance Officer, Financial Services Telephone Number 01323 415149.
Recommendations:	Members are asked recommend to Council;

i) The Treasury Management Strategy and Annual Investment Strategy as set out in this report.

ii) The methodology for calculating the Minimum Revenue Provision set out at paragraph 2.3.

iii) The Prudential and Treasury Indicators as set out in this report.

iv) The Specified and Non-specified Investment categories listed in Appendix 3.

1.0 Introduction

1.1 The Council is required to receive and approve, the Prudential and Treasury Indicators and Treasury Strategy as part of the budget setting process each year. This covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

1.2 These elements cover the requirements of the Local Government Act 2003, the CIFPA Prudential Code, the CLG MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

1.3 The Council adopted CIPFA's Treasury Management code of Practice on 18 May 2010. This code is supported by treasury management practices (TMPs) that set out the manner in with the council seeks to achieve the treasury management strategy and prescribes how it manages and controls those activities.

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2013/14 – 2017/18

2.1 Capital Expenditure

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 member overview and confirm capital expenditure plans.

The table below summarises the Council's capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

The capital expenditure forecasts for the Council are:

Capital Expenditure £m	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Non-HRA	8.5	7.4	16.5	9.1	0.4
HRA	7.4	11.7	9.7	5.7	4.4
LAMS	1.0	0.0	0.0	0.0	0.0
Total	16.9	19.1	26.2	14.8	4.8
Financed by:					
Capital receipts	0.1	2.1	4.3	1.1	0.2
Capital grants & external funding	1.8	2.0	11.0	7.9	0.1
Capital reserves	5.8	7.1	5.3	4.2	4.4
Revenue	0.5	1.4	0.8	0.3	0.0
Loans to third party LAMS	1.0				
Net borrowing needed for the year	**7.7**	**6.5**	**4.8**	**1.3**	**0.1**

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

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.

Following accounting changes the CFR includes other long term liabilities (e.g. Serco, PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme already include a borrowing facility and the Council is not required to separately borrow for them. There are currently £1.3m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£m	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Capital Financing Requirement					
CFR – non housing	25.0	27.6	28.5	27.8	26.2
CFR - housing	37.5	40.5	42.9	43.4	43.4
Total CFR	**62.5**	**68.1**	**71.4**	**71.2**	**69.6**
Movement in CFR	**6.6**	**5.6**	**3.3**	**(0.2)**	**(1.6)**

Movement in CFR represented by					
Net financing needed for the year (above)	7.7	6.5	4.8	1.3	0.1
Less MRP and other financing movements	(1.1)	(0.9)	(1.4)	(1.6)	(1.6)
Movement in CFR	**6.6**	**5.6**	**3.4**	**(0.3)**	**(1.5)**

Note the MRP includes Serco repayments.

2.3 MRP Policy Statement

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 minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

Regulations require the Council to approve an MRP Statement in advance of each financial year. A variety of options are provided to councils, so long as there is a prudent provision. It is recommended that the following methodology, as used in previous years, be continued:

- For capital expenditure incurred before 1.4.2008 MRP is provided for at 4% of the CFR.
- For capital expenditure incurred since 1.4.2008 MRP be charged using the most appropriate of the following two methods for the individual schemes as determined by the Chief Finance Officer under delegate powers
  - Asset Life method – based on the estimated life of the asset,
  - Depreciation method – based on standard depreciation accounting procedures.

No revenue charge is currently required for the HRA. However under HRA reform the HRA is required to charge depreciation on its assets, which will have a revenue effect. In order to address any possible adverse impact, regulations allow the Major Repairs Allowance to be used as a proxy for depreciation for the first five years.

Repayments included in annual Serco payments and any finance leases are applied as MRP.

The Council has agreed to participate in LAMS (Local Authority Mortgage Scheme) 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 Capital Financing Requirement (CFR) increased by the amount of the total indemnity. The deposit is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. 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**

The previous sections cover 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. Note that indicators are required to be prepared on the gross capital spend and do not include any resulting income contributions expected from the implementation of the capital scheme. The Council is asked to approve the following indicators:

2.4.1 **Actual and estimates of the 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.

%	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Non-HRA	6.4	7.6	9.6	11.3	11.6
HRA	10.3	11.8	11.6	12.1	12.1

The estimates of financing costs include current commitments and the proposals in the budget reports.

2.4.2 **Incremental impact of capital investment decisions on the band D council tax -**This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the budget reports compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget estimates as well as other assumptions based on the Council's Medium Term Financial Strategy.

£	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Council Tax - B**and D**	12.16	3.98	7.99	6.66	1.54

The increase in 2013/14 is attributable to the Local Council Tax Support Scheme which reduced the Council Tax Base by more than 4,500 band D properties.

2.4.3 **Incremental impact of capital investment decisions on housing rent levels** - Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

£	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Weekly housing rent levels	0.02	(0.21)	(0.59)	(0.08)	(0.00)

This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

3.0 TREASURY MANAGEMENT STRATEGY

The capital expenditure plans set out in Section 2 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 approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2014, with forward projections, are summarised below. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement - CFR), highlighting any under borrowing (ie the use of revenue cash balances referred to as internal balances).

£m	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
External borrowing					
Borrowing at 1 April	39.2	42.4	47.4	55.1	57.2
Expected change in borrowing	2.0	3.6	6.7	1.3	0.1
Other long-term liabilities (OLTL)	1.5	1.2	1.3	1.0	0.7
Expected change in OLTL	(0.2)	0.1	(0.3)	(0.3)	0.3
Actual gross borrowing at 31 March	**42.4**	**47.4**	**55.1**	**57.2**	**58.3**
CFR – the borrowing need	62.5	68.1	71.4	71.2	69.6
Use of internal balances	20.1	20.7	16.3	14.0	11.3
Investments	0.1	2.0	0.0	0.0	0.0
Net borrowing	**42.3**	**45.4**	**55.1**	**57.2**	**58.3**

Within the prudential indicators there are a number of key 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 borrowing 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 2014/15 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.

Whilst investment interest rates continue to be below that for borrowing, value for money can be best achieved by avoiding new borrowing and using internal cash balances to temporarily finance new capital expenditure or to replace maturing external debt, thus maximising short term savings. However this needs to be carefully considered to ensure borrowing is taken at advantageous rates, but not taken too long before the need to borrow to avoid the cost of carrying the debt.

3.2 **Treasury Indicators: Limits to Borrowing Activity**

3.2.1 **The Operational Boundary.** This is the limit beyond which external borrowing is not normally expected to exceed.

The Council is asked to approve the following operational boundary limits:

Operational boundary £m	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing	66.8	70.4	70.5	68.6
Other long term liabilities	1.3	1.0	0.7	1.0
Total	68.1	71.4	71.2	69.6

3.2.2 **The Authorised Limit for external borrowing -** This represents a limit beyond which external borrowing is prohibited:

The Council is asked to approve the following authorised limit**:**

Authorised limit £m	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing	81.8	85.4	85.5	83.6
Other long term liabilities	1.3	1.0	0.7	1.0
Total	83.1	86.4	86.2	84.6

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime of £42.96m. This limit, included in the authorised limits above, is currently:

HRA Debt Limit £m	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total	40.5	42.9	43.4	43.4

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

3.3 **Prospects for Interest Rates**

The Council has appointed Capita Asset Services (Capita) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Appendix 1 draws together Capita's view plus a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates.

A combination of the following and other factors has caused Capita to put back the start of increases in Bank Rate from Q2 2015 to Q4 with knock on delays on increases in following years.

- The plunge in the price of oil has been the major surprise of the last three months. This will reduce inflation and stimulate the economies of oil importing countries.

- UK GDP growth forecasts have recently been more subdued although growth will still remain strong, but not as strong as previously expected.

- The political risks around the UK general election in May 2015 have increased with the likely result now being very hard to predict.

They have also had to bring their short term PWLB forecasts down to reflect current abnormally low levels which are unsustainably low. However, how quickly or slowly they will unwind is very hard to predict.

Investment returns are likely to remain relatively low during 2015/16 and beyond.

Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when we will not be able to avoid new borrowing to finance new capital expenditure and to refinance 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

A detailed view of the Econcomic forecast is set out at Appendix 2.

3.4 **Borrowing Strategy**

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as 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 high and will be maintained.

There is an underlying need to borrow in the future to support capital expenditure and new external borrowing will be required by the end of this year. Rates are currently being monitored and new borrowing will be taken when the rates are advantageous either as long term debt or temporary borrowing. Against the current econcomic background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

The Council will maintain a balanced, affordable and sustainable maturity profile as set out below and all new borrowing will be undertaken in line with this policy.

3.5 Treasury Management Limits on Activity

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.

The Council is asked to approve the following treasury indicators and limits:

	2015/16	2016/17	2017/18
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%
Maturity Structure of fixed interest rate borrowing 2015/16			
		Lower	**Upper**
Under 12 months		0%	25%
12 months to 2 years		0%	50%
2 years to 5 years		0%	75%
5 years to 10 years		0%	100%
10 years and above		0%	100%

3.6 Policy on Borrowing in Advance of Need

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 Capital Financing Requirement 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.

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.

3.7 Debt Rescheduling

As short term borrowing rates are currently 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.

Debt scheduling will only be considered under the following circumstances:

- the generation of cash savings and /or discounted cash flow produce sufficent savings to cover the costs;
- it helps to fulfil the treasury strategy; and
- the balance of the portfolio (amend the maturity profile and/or the balance of volatility) is maintained.

Consideration will also be given to identify 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.

All rescheduling will be reported to Cabinet, at the earliest meeting following its action.

3.8 **Municipal Bond Agency**

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

3.9 **ANNUAL INVESTMENT STRATEGY**

3.9.1 **Investment Policy**

The Council's investment policy has regard to the CLG'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 main priorities will be security first, liquidity second, then return.

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 at appendix 3 and
- 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.

3.9.2 **Creditworthiness Policy**

In order to minimise the risk to investments, the Council has clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list as set out in at Appendix 4 . The aim is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

Credit rating information is supplied by Capita, the Council's treasury consultants, on all active counterparties that comply with the criteria at Appendix 4. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of 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.

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA from Fitch, as well as UK, which is currently rated AA+.

The Chief Finance Officer will maintain a counterparty list in compliance with the criteria set out in Appendix 4 and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either Specified or Non-Specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The Local Authority Mortgage Scheme (LAMS) –

The Council is particpating in the cash backed mortgage scheme which requires the Council to place a matching five year deposit to the life of the indemnity. This investment is an integral part of the policy initiative and is outside the criteria above.

Time and monetary limits applying to investments.

The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both Specified and Non-Specified Investments):

	Money Limit	Time Limit
Banks 1 category high quality	£5.0m	1 yr
Banks 2 category – part nationalised	£5.0m	1 yr
Limit 3 category – Council's banker (not meeting Banks 1)	£10.0m	1 day
Other institutions limit	£5.0m	1 yr
DMADF	Unlimited	6 months
Local authorities	£5.0m	1 yr
Money market Funds	£10.0m	Liquid

The proposed criteria for Specified and Non-Specified investments are shown in Appendix 3 for approval.

3.9.3 **Investment Strategy**

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).

3.9.4 **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2015/ 2016 0.75%
- 2016/2017 1.25%
- 2017/2018 2.00%

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

The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next three years are as follows:

2015/16	0.60%
2016/17	1.25%
2017/18	1.75%

3.9.5 **Investment treasury indicator and limit** - Total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit:

Maximum principal sums invested > 364 days			
£m	**2015/16**	**2016/17**	**2017/18**
Principal sums invested > 364 days	£2.0m	£2.0m	£2.0m

For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

3.9.6 **End of year investment report**

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

3.10 **Policy on the use of external service providers**

The Council uses Capita as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times.

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.

4.0 Resource Implications

All implications have been factored into the 2015/16 budget setting process.

Alan Osborne
Chief Finance Officer

Background Papers:

The Background Papers used in compiling this report were as follows:

CIPFA Treasury Management in the Public Services code of Practice (the Code)
Cross-sectorial Guidance Notes
CIPFA Prudential Code
Treasury Management Strategy and Treasury Management Practices adopted by the Council on 18 May 2010.
Council Budget 4 February 2015
Finance Matters and Performance Monitoring Reports 2014.

To inspect or obtain copies of background papers please refer to the contact officer listed above.

APPENDIX 1 Interest rate Forecast 2015/18

Capita Asset Services Interest Rate View													
	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.10%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	0.70%	0.80%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.30%
12 Month LIBID	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yr PWLB Rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB Rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
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%	1.75%	1.75%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
Capital Economics	2.20%	2.50%	2.70%	3.00%	3.10%	3.20%	3.30%	3.40%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
Capital Economics	2.80%	3.05%	3.30%	3.55%	3.60%	3.65%	3.70%	3.80%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.25%	3.45%	3.65%	3.85%	3.95%	4.05%	4.15%	4.25%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.30%	3.50%	3.70%	3.90%	4.00%	4.10%	4.20%	4.30%	-	-	-	-	-
Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012													

Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

APPENDIX 2 Economic Background

UK. After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

Eurozone (EZ). The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November 2014, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. It now appears likely that the ECB will embark on full quantitative easing (purchase of EZ country sovereign debt) in early 2015.

Concern in financial markets for the Eurozone subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international competitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

Greece: the general election due to take place on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries which have high unemployment rates. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti austerity policies. Any loss of market confidence in either of the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

USA. The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently forecast that the first increase in the Fed. rate will occur by the middle of 2015.

China. Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for many years. There are also concerns that the Chinese leadership has only started to address an unbalanced economy which is heavily over dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan. Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession in Q2 and Q3. The Japanese government already has the highest debt to GDP ratio in the world.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data transpires over 2015. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing 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 evenly balanced. 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.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

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

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK strong economic growth is weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- 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 to 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: -

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government
- ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.
- The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.
- A surge in investor confidence that a return to robust world economic growth is imminent, causing a flow of funds out of bonds into 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 - Specified and Non-Specified Investments and Limits

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

	*** Minimum 'High' Credit Criteria**
Debt Management Agency Deposit Facility	--
Term deposits – local authorities	--
Term deposits – banks and building societies (See appendix 5 for approved Counties)	Green - See note below
Collateralised deposit	UK sovereign rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating
UK Government Gilts	UK sovereign rating
Bonds issued by multilateral development banks	AAA
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO – Guaranteed Export Finance Corporation)	UK sovereign rating
Sovereign bond issues (other than the UK govt)	AAA
Treasury Bills	UK sovereign rating

Term deposits with nationalised banks and banks and building societies

	Minimum Credit Criteria	**Max % of total investments**	**Max. maturity period**
UK part nationalised banks	Blue - See note below	£5.0m	1 year

Eastbourne Borough Council uses Capita's credit worthiness service which overlays colour bandings to determine the maximum length of any investment. See Appendix 4 for further detail.

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of 25% will be held in aggregate in non-specified investment.

Maturities in excess of 1 year

	Minimum Credit Criteria	**Max % of total investments**	**Max. maturity period**
Term deposits – local authorities	--	£2m with any institution	2 years
Term deposits – banks and building societies	Green	£2m with any institution	2 years
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	UK sovereign rating	£2m with any institution	2 years
Certificates of deposit issued by banks and building societies	Green	£2m with any institution	2 years
UK Government Gilts	UK sovereign rating	£2m with any institution	2 years
Bonds issued by multilateral development banks	AAA	£2m with any institution	2 years
Sovereign bond issues (other than the UK govt)	AAA	£2m with any institution	2 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)			
1. Bond Funds	Long-term AA- volatility rating	£2m with any institution	2 years
2. Gilt Funds	Long-term AA- volatility rating	£2m with any institution	2 years

Local Authority Mortgage Scheme.
Under this scheme the Council is required to place funds of £1,000,000, with the Lender for a period of 5 years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified / non specified categories.

APPENDIX 4 – Creditworthiness Policy

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

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

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. The Council will therefore use counterparties within the following durational bands:

- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used.

This methodology does not apply the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Capita 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.

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of Short Term rating F1, Long Term rating A-, Individual of Viability ratings of C- (or BB+), and a Support rating of 3. 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.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita 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 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 weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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