

Treasury Management and Annual Investment Strategy 2016/17

1 Introduction

1.1 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’.

1.2 The strategy covers:

- Statutory and regulatory requirements
- Balanced budget requirement
- Prudential and treasury Indicators
- Borrowing requirement
- Current treasury position
- Prospects for interest rates
- Credit rating agencies
- Investment policy
- Creditworthiness policy
- Country, counterparty and group exposure limits
- Cash flow and core fund Investment strategies
- Year end investment report
- Policy on use of external service providers.

2 Statutory and regulatory requirements

2.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to ‘have regard to’ the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

2.2 The Act requires the Council to set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy

which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

- 2.3 The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009 (The Code of Practice).
- 2.4 The Code of Practice was adopted by this Council on 18 February 2010. In preparing this strategy due regard has also been given to the Code's subsequent revisions.
- 2.5 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, including the Annual Investment Strategy, for the year ahead; a Mid-year Review Report; and an Annual Report (stewardship report) covering activities during the previous year.
 - 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.
 - Delegation by the Council of the role of scrutiny of the Treasury Management Strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.
- 2.6 The scheme of delegation and role of the Section 151 officer that give effect to these requirements are set out at **[Appendix 1]**.

3 Balanced budget requirement

- 3.1 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 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 within the projected income of the Council for the foreseeable future.

4 Prudential and treasury indicators

- 4.1 It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.
- 4.2 The Council must have regard to the Prudential Code when setting the 'Authorised Limit', which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.
- 4.3 Whilst termed an 'Affordable Borrowing Limit', the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The 'Authorised Limit' is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.
- 4.4 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on 30 September 2003 and the revised 2009 Code was adopted by the full Council on 18 February 2010. Subsequent Code amendments are also complied with.
- 4.5 Prudential and Treasury Indicators relevant to setting an integrated treasury management strategy are set out in **[Appendix 2]**.

5 Borrowing requirement

- 5.1 Other than for cash flow purposes and then within the limits set out at **[Appendix 2]** borrowing will not be necessary. All capital expenditure in 2016/17 will be funded from the Revenue Reserve for Capital Schemes, grants, developer contributions and capital receipts arising from the sale of assts.

- 5.2 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

6 Current treasury position

- 6.1 The Council is debt free and as such the overall treasury position at 31 December 2015 comprised only investments which totaled £34m generating an average return of 0.76%.

7 Prospects for interest rates

- 7.1 The Council has appointed Capita Asset Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. **[Appendix 3]** draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. Capita's expectation for the Bank Rate for the financial year ends (March) is:

- 2015/ 2016 0.50%
- 2016/ 2017 1.00%
- 2017/ 2018 1.75%
- 2018/ 2019 2.00%

- 7.2 **UK.** UK GDP growth rates in 2013 of 2.2% 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 the 2015 growth rate is likely to be a leading rate in the G7 again, probably being second to the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y) before weakening again to +0.5% (2.3% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 - 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 CPI inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, most worldwide economic statistics have been weak and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

- 7.3 The Inflation Report was also notably subdued in respect of the forecasts for inflation which was expected to get back up to the 2% target over a 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 and early 2016 but a second, more recent round of falls in fuel prices will now delay any significant rise in inflation: this is now expected to get back to around 1% in the second half of 2016 and approach 2% in 2017, though the forecasts in the Report itself were for an even slower rate of increase. There is 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 start to increase the Bank Rate.

- 7.4 **USA.** 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 pulled back to 2.1% in quarter 3. The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 prepared the way for the Federal Reserve 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.
- 7.5 **EZ.** In the Eurozone, the ECB commenced a significant €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. This appears to have had a positive effect in helping a recovery in consumer and business confidence and has led to an improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% in quarter 3. However, the limited progress in 2015 together with the recent downbeat Chinese and emerging markets news, has prompted comments by the ECB that it stands ready to strengthen the QE programme by extending its time frame and / or increasing its size in order to get inflation up from the current level of around zero towards its target of 2% and to help boost the rate of growth in the EZ.
- 7.6 **Greece.** During July, Greece finally agreed to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. The surprise general election in September gave the Syriza government a mandate to stay in power to implement the austerity measures. Doubt remains

as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro is still a possibility.

- 7.7 **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 power. A left wing coalition has taken power in Portugal which is heading towards unravelling previous pro-austerity reforms. This outcome could be replicated in Spain and 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.
- 7.8 A more detailed view of the current economic background, provided by Capita, is contained in **[Appendix 4]**.

8 Credit rating agencies

- 8.1 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' in anticipation 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. 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. A consequence of these new methodologies is that they have also lowered the importance of the Fitch 'Support and Viability' ratings and have seen Moody's 'Financial Strength' rating withdrawn by the agency.
- 8.2 In keeping with the agencies' new methodologies, the rating element of Capita's 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 represents a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to the Capita process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.
- 8.3 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. In the early part

of the Financial crisis the Council incorporated the highest sovereign rating (AAA) into its credit criteria. The new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA-. 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, and sentiment towards, a financial institution.

- 8.4 These rating agency changes do not reflect any changes in the underlying status or credit quality of an 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. 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. 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.

9 Investment policy

- 9.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments (the Guidance) and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA TM Code). The Council's investment priorities will be security first, liquidity second, and then return.
- 9.2 In accordance with the above guidance from the CLG 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. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.
- 9.3 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.

- 9.4 Other information sources used will include the financial press, share price and other information relating to the banking sector in order to establish a robust scrutiny process on the suitability of potential investment counterparties.
- 9.5 Investment instruments identified for use in the financial year are listed in **[Appendix 5]** under the 'specified' and 'non-specified' investments categories. Counterparty limits are detailed in section 11 below.

10 Creditworthiness policy

- 10.1 The creditworthiness service provided by Capita has been progressively enhanced over the last few years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings are supplemented using 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; and
 - sovereign ratings to select counterparties from only the most creditworthy countries.
- 10.2 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 code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to inform the maximum duration of an investment and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments.
- 10.3 The selection of counterparties with a high level of creditworthiness is achieved by selecting institutions down to a minimum durational band within Capita's weekly credit list of potential counterparties (worldwide). Subject to an appropriate sovereign and counterparty rating the Council uses counterparties within the following durational bands:

Yellow	5 years
Purple	2 years
Blue	1 year (nationalised or part nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 Days

- 10.4 The Council does not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. Moody's tends to be more aggressive in giving low ratings than the other two agencies and adopting the CIPFA approach may leave the Council with too few banks on its approved lending list. The Capita creditworthiness service uses a wider array of information than just primary ratings and in combination with a risk weighted scoring system undue preponderance is not given to any one agency's ratings.
- 10.5 All credit ratings are reviewed weekly and monitored on a daily basis. 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 no longer meeting the Council's minimum criteria its use for new investment is withdrawn immediately.
 - In addition to the use of credit ratings the Council is advised of movements in Credit Default Swap data against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in a scaling back of the duration assessment or removal from the Councils lending list altogether.
- 10.6 Sole reliance is not placed on the use of the Capita service. In addition the Council uses market information including information on any external support for banks to assist the decision making process.

11 Country, counterparty and group exposure limits

- 11.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- as determined by all three rating agencies - Fitch, Moody's and Standard and Poor's. The list of countries that qualify using this credit criteria as at the date of this report are shown in **[Appendix 6]**. The list will be amended in accordance with this policy should ratings change.
- 11.2 Avoidance of a concentration of investments in too few counterparties or countries is a key to effective diversification and in this regard the limits set out below are thought to achieve a prudent balance between

Annex 4

risk and practicality and are applicable to both cash flow and core fund investment.

Country, Counterparty and Group exposure	Maximum Proportion of Cash Flow and Core Funds
UK Sovereign (subject to a minimum rating of AA-)	100%
Each non-UK Sovereign rated AA- or better	20%
Group limit excluding UK nationalised / part nationalised banks	20%
Each counterparty rated Fitch A-, F1 (green excluding CDS using Capita's credit methodology) or better	20%
Each UK nationalised or part nationalised bank / group	25%
Each AAA multilateral / supranational bank	20%
Each AAA rated bond fund / gilt fund / enhanced cash fund / government liquidity fund / equity fund or property fund subject to maximum 20% exposure to all such funds	10%
Each money market fund rated Moody's AAAMf or Fitch AAAMmf, or Standard & Poor's AAAM	20%
Non-specified investments over 1 year duration	60%

11.3 Cash flow balances vary depending on the timing of receipts and payments during the month and from month to month. For cash flow investment the limits identified in paragraph 11.2 will be based on an estimate of the expected average daily cash flow balance at the start of the financial year.

12 Cash flow and core fund investment strategies

12.1 Funds available for investment are split between cash flow and core funds. Cash flow funds are generated from the collection of council tax, business rates and other income streams. They are consumed during the financial year to meet payments to precepting authorities and government (NNDR contributions) and to meet service delivery costs (benefit payments, staff salaries and suppliers in general). The consumption of cash flow funds during the course of a financial year

places a natural limit on the maximum duration of investments (up to one year). Core funds comprise monies set aside in the Council's revenue and capital reserves and are generally available to invest for durations in excess of one year.

- 12.2 **Cash flow investments.** The average daily cash flow balance throughout 2016/17 is expected to be £11.0m with a proportion available for longer than three months. Cash flow investments will be made with reference to cash flow requirements (liquidity) and the outlook for short-term interest rates i.e. rates for investments up to 12 months. Liquidity will be maintained by using bank deposit accounts and money markets funds. Where duration can be tolerated, additional yield will be generated by utilising term deposits with banks and building societies and enhanced cash funds. Cash balances available for more than 3 months may be transferred to the core fund portfolio if a better overall return for the Council can be achieved by doing so.
- 12.3 In compiling the Council's estimates for 2016/17 a return on cash flow investments of 0.75% has been assumed. This return is a modest uplift on the return being achieved in 2015/16 (0.66% to December 2015) and anticipates the Bank Rate will rise above the current 0.5% summer 2016.
- 12.4 **Core fund investments.** Historically the Council's core funds have been managed by an external fund manager. All core funds were returned to the Council for in-house management during 2014/15. The core fund balance is diminishing as a proportion is consumed each year (approximately £2m per annum) to support the Council's revenue budget and capital expenditure plans. The average core fund balance during 2016/17 is expected to be £12m.
- 12.5 The Council will avoid locking into longer term deals while investment rates continue their current low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and are within the risk parameters set by this Council.
- 12.6 In compiling the Council's estimates for 2016/17 a return on core fund investments of 1.0% has been assumed. This return anticipates an uplift in yield will be generated over cash flow investment expectations and offers a modest increase on the current core fund return (0.82% to December 2015). Subject to the credit quality and exposure limits outlined in paragraph 11.2, liquidity and yield will be achieved by a mix of investments using predominantly fixed term deposits and certificates of deposit. Notice accounts and enhanced cash funds will also be used if these offer favourable returns relative to term deposits.

13 Year end investment report

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

14 Policy on the use of external service providers

14.1 The Council uses Capita as its external treasury management advisors.

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

14.3 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.

January 2016

Appendices

1. Treasury management scheme of delegation
2. Prudential and Treasury indicators
3. Interest rate forecasts
4. Economic background provided by Capita Asset Services
5. Specified and Non-specified Investments
6. Approved countries for investments

Appendix 1 Treasury management scheme of delegation**Full Council**

- Budget approval.
- Approval of treasury management policy.
- Approval of the Annual Treasury Management Strategy and Annual Investment Strategy.
- Approval of amendments to the Council's adopted clauses, Treasury Management Policy and the Annual Treasury Management Strategy and Annual Investment Strategy.
- Approval of the treasury management outturn report.

Cabinet

- Budget consideration.
- Approval of Treasury Management Practices.
- Approval of the division of responsibilities.
- Approval of the selection of external service providers and agreeing terms of appointment.
- Acting on recommendations in connection with monitoring reports.

Audit Committee

- Reviewing the Annual Treasury Management Strategy and Annual Investment Strategy and making recommendations to Cabinet and Council.
- Receive reports on treasury activity at regular intervals during the year and making recommendations to Cabinet.
- Reviewing treasury management policy, practices and procedures and making recommendations to Cabinet and Council.

Finance, Innovation and Property Advisory Board

- Receiving budgetary control reports at regular intervals that include treasury management performance.

The S151 (responsible) officer

- 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.
- Recommending the appointment of external service providers.

Appendix 2 Prudential and Treasury Indicators

The prudential indicators relating to capital expenditure cannot be set until the capital programme is finally determined and will as a consequence be reported as part of the Setting the Budget for 2016/17 report that is to be submitted to Cabinet on 11 February 2016.

The treasury management indicators are as set out in the table below:

TREASURY MANAGEMENT INDICATORS	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt :					
borrowing	Nil	5,000	5,000	5,000	5,000
other long term liabilities	Nil	Nil	Nil	Nil	Nil
TOTAL	Nil	5,000	5,000	5,000	5,000
Operational Boundary for external debt:-					
borrowing	Nil	2,000	2,000	2,000	2,000
other long term liabilities	Nil	Nil	Nil	Nil	Nil
TOTAL	Nil	2,000	2,000	2,000	2,000
Actual external debt	Nil	Nil	Nil	Nil	Nil
Upper limit for fixed interest rate exposure > 1 year at year end	Nil	It is anticipated that exposure will range between 0% to 60%			
Upper limit for variable rate exposure < 1 year at year end	11,466 (58.9%)	It is anticipated that exposure will range between 40% to 100%			
Upper limit for total principal sums invested for over 364 days at year end	Nil (0%)	60% of core funds			

Maturity structure of fixed rate borrowing during 2015/16 - 2018/19	upper limit	lower limit
under 12 months	100 %	0 %
Over 12 months	0 %	0 %

Appendix 3 Interest Rate Forecasts - January 2016

Capita Asset Services Interest Rate View														
	Dec-15	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%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
3 Month LIBID	0.60%	0.70%	0.80%	0.90%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	1.90%	2.00%	2.00%	2.10%
6 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.10%	2.20%	2.20%	2.30%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.40%	2.50%	2.50%	2.70%
5yr PWLB Rate	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
10yr PWLB Rate	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
25yr PWLB Rate	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
50yr PWLB Rate	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%
Bank Rate														
Capita Asset Services	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	-	-	-	-	-
5yr PWLB Rate														
Capita Asset Services	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
Capital Economics	2.40%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-
10yr PWLB Rate														
Capita Asset Services	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
Capital Economics	3.35%	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
25yr PWLB Rate														
Capita Asset Services	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
Capital Economics	3.35%	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
50yr PWLB Rate														
Capita Asset Services	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%
Capital Economics	3.40%	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

Appendix 4 Economic Background Provided by Capita Asset Services

UK. 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 the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 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 5.2%.

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% y/y. 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 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but only to be followed by a second, more recent, round of falls in fuel prices which will now 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 2017, though the forecasts in the Report itself were for an even slower rate of increase.

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 to them given that central rates are near to zero and huge QE is already in place. There are, accordingly, arguments that they need to raise rates sooner, rather than later, 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 raise rates until they are

sure that growth was securely embedded and 'no inflation' was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 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.

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 Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded remarkably strongly in Q2 to 3.9% (annualised) before falling back to +2.1% in Q3.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Federal Reserve (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 very strong and November was also reasonably strong; 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.

EZ. In the Eurozone, the ECB commenced a significant €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. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to an improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% in quarter 3. However, the limited progress in 2015 together with the recent downbeat Chinese and emerging markets news, has prompted comments by the ECB that it stands ready to strengthen the QE programme by extending its time frame and / or increasing its size in order to get inflation up from the current

level of around zero towards its target of 2% and to help boost the rate of growth in the EZ.

Greece. During July, Greece finally agreed to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. The surprise general election in September gave the Syriza government a mandate to stay in power to implement the austerity measures. Doubt remains as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro is still a possibility.

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 power. A left wing coalition has taken power in Portugal which is heading towards unravelling previous pro austerity reforms. This outcome could be replicated in Spain. 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 Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 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 Government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its 'arrows' of reform but has hesitated about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market during the summer. Some commentators are concerned that recent growth figures may lack accuracy and be hiding a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of the bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that many would envy. Nevertheless, concerns about whether the Chinese economy could be heading for a hard landing, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, remain a concern.

Emerging countries. There are also concerns about the vulnerability of some emerging countries and their corporates. 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 an imminent rise in interest rates and bond yields.

This change in investors' strategy, and the reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US, has helped to cause 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. 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. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. Capita Asset Services undertook its last review of interest rate forecasts on 9 November 2015 shortly after the publication of the quarterly Bank of England Inflation Report. 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 2 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. 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.

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 November, (based on short sterling), for the first Bank Rate increase are currently around mid-year 2016.

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 economic growth turns significantly 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.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed rate increases, causing a flight to safe havens

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.
- US Federal Reserve 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 5 Specified and Non-specified Investments

All specified and non-specified Investments will be:

Subject to the sovereign, counterparty and group exposure limits identified in the Annual Investment Strategy.

Subject to the duration limit suggested by Capita **(+3 months for UK Financial Institutions)** at the time each investment is placed.

Subject to a maximum of 60% of core funds, in aggregate, being held in non-specified investments at any one time.

Sterling denominated.

Specified Investments (maturities up to 1 year):

Investment	Minimum Credit Criteria
UK Debt Management Agency Deposit Facility	UK Sovereign AA-
Term deposits - UK local authorities	UK Sovereign AA-
Term deposits - UK nationalised and part nationalised banks	UK Sovereign AA-
Term deposits - banks and building societies	UK / Non-UK Sovereign AA-. Counterparty A-, F1 or Green excluding CDS
Certificates of deposit - UK nationalised and part nationalised banks	UK Sovereign AA-
Certificates of deposit - banks and building societies	UK / Non-UK Sovereign AA-. Counterparty A-, F1, or Green excluding CDS
UK Treasury Bills	UK Sovereign AA-
UK Government Gilts	UK Sovereign AA-
Bonds issued by multi-lateral development banks	AAA
Sovereign bond issues (other than the UK govt)	AAA

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):	
1. Money Market Funds	At least one of : Moody's AAAMf, Fitch AAAMmf, Standard and Poor's AAAM
2. Government Liquidity Funds	AAA
3. Enhanced Cash Funds	AAA
4. Bond Funds excluding corporate bonds	AAA
5. Gilt Funds	AAA
6. Equity Funds	AAA
7. Property Funds	AAA

Non-specified Investments (maturities in excess of 1 year and any maturity if not included above):

Investment	Minimum Credit Criteria	Max duration to maturity
Fixed term deposits with variable rate and variable maturities (structured deposits) - UK nationalised and part nationalised banks	UK Sovereign AA-	2 years
Fixed term deposits with variable rate and variable maturities (structured deposits) - banks and building societies	UK / Non-UK Sovereign AA-. Counterparty A-, F1 (Green)	2 years
Term deposits - local authorities	UK Sovereign AA-	2 years
Term deposits - UK nationalised and part nationalised banks	UK Sovereign AA-	2 years
Term deposits - banks and building societies	UK / Non-UK Sovereign AA-. Counterparty A-, F1(Green)	2 years
Certificates of deposit - UK nationalised and part nationalised banks	UK Sovereign AA-	2 years

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Certificates of deposit - banks and building societies	UK / Non-UK Sovereign AA-. Counterparty A- F1 (Green)	2 years
Commercial paper - UK nationalised and part nationalised banks	UK Sovereign AA-	2 years
Commercial paper - banks and building societies	UK / Non-UK Sovereign AA-. Counterparty A-, F1 (Green)	2 years
Floating rate notes issued by multilateral development banks	AAA	5 years
Bonds issued by multilateral development banks	AAA	5 years
Sovereign bond issues (other than the UK Government)	AAA	5 years
UK Government Gilts	UK Sovereign AA-	Max of 25% 5 years
UK Government Gilts	UK Sovereign AA-	Max of 25% 10 years

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.

Appendix 6 Approved countries for investments

All counterparties in addition to meeting the minimum credit criteria specified in the Annual Investment Strategy must be regulated by a sovereign rated as a minimum AA- by each of the three rating agencies - Fitch, Moody's and Standard and Poor's.

This list will be reviewed and amended if appropriate on a weekly basis by the Director of Finance and Transformation.

As of 31 December 2015 sovereigns meeting the above requirement which also have banks operating in sterling markets with credit ratings of green or above on the Capita Asset Services' Credit Worthiness List of that date were:

AAA	Australia Canada Denmark Germany Netherlands Singapore Sweden Switzerland
AA+	Finland UK USA
AA	Abu Dhabi (UAE) France Qatar
AA-	Belgium