

Treasury Management Strategy Statement and Investment Strategy 2016/17 to 2018/19



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1. Background

- 1.1. On 23rd February 2012 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.
- 1.2. In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.
- 1.3. The report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.
- 1.4. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

2. External Context

- 2.1 **Economic background:** Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Low oil and commodity prices were a notable feature of 2015, and contributed to annual CPI inflation falling to 0.1% in October. Wages are growing at 3% a year, and the unemployment rate has dropped to 5.4%. Mortgage approvals have risen to over 70,000 a month and annual house price growth is around 3.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 81st consecutive month at its meeting in November 2015. Quantitative easing (QE) has been maintained at £375bn since July 2012.
- 2.2 Following the General Election, the key issue of the UK's relationship with the EU is at the heart of future politics. Uncertainty over the outcome of the forthcoming referendum could put downward pressure on UK GDP growth and interest rates.
- 2.3 China's growth has slowed and its economy is performing below expectations, reducing global demand for commodities and contributing to emerging market weakness. US domestic growth has accelerated but the globally sensitive sectors of the US economy have slowed. Strong US labour market data and other economic indicators however suggest recent global turbulence has not knocked the American recovery off course. The Federal Reserve did not raise policy rates at its meetings in October and November, but the statements accompanying the policy decisions point have made a rate hike in December 2015 a real possibility. In contrast, the European Central Bank finally embarked on QE in 2015 to counter the perils of deflation.
- 2.4 **Credit outlook:** The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK Banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.
- 2.5 Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and Germany. The rest of the European Union will follow suit in January

2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain stubbornly low.

- 2.6 **Interest rate forecast:** The Authority's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.
- 2.7 A shallow upward path for medium term gilt yields is forecast, as continuing concerns about the Eurozone, emerging markets and other geo-political events weigh on risk appetite, while inflation expectations remain subdued. Arlingclose projects the 10 year gilt yield to rise from its current 2.0% level by around 0.3% a year. The uncertainties surrounding the timing of UK and US interest rate rises are likely to prompt short-term volatility in gilt yields.
- 2.8 A more detailed economic and interest rate forecast provided by the Authority's treasury management advisor is attached at **Annex A**.
- 2.9 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1.00%.

3. Local Context

- 3.1 The Authority currently has borrowings of £109m and investments of £69m. This is set out in further detail at **Annex B**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.3.15 Actual £m	31.3.16 Estimate £m	31.3.17 Estimate £m	31.3.18 Estimate £m	31.3.19 Estimate £m
General Fund CFR	232	248	310	377	359
Less: Other long-term liabilities *	-31	-30	-28	-27	-25
Borrowing CFR	201	218	282	350	334
Less: External borrowing **	-115	-109	-102	-96	-72
Internal (over) borrowing	86	109	180	254	262
Less: Usable reserves	-87	-61	-58	-58	-56
Less: Working capital	-48	-47	-47	-47	-47
Investments (or New borrowing)	49	(1)	(75)	(149)	(159)

* finance leases and PFI liabilities that form part of the Authority's debt

** shows only loans to which the Authority is committed and excludes optional refinancing

- 3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to

maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, subject to holding a minimum investment balance of around £20m for liquidity purposes.

- 3.3 The Authority has an increasing CFR due to the capital programme and will therefore be required to borrow up to £116m over the forecast period.
- 3.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2016/17.

4. Borrowing Strategy

- 4.1 The Authority currently holds loans of £109m, a decrease of £6m on the previous year, as part of its strategy for funding previous years' capital programmes.
- 4.2 The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.
- 4.3 Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.
- 4.4 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2016/17 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- 4.5 Alternatively, the Authority may arrange forward starting loans during 2016/17, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.
- 4.6 In addition, the Authority may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.
- 4.7 The approved sources of long-term and short-term borrowing are:
- Public Works Loan Board and any successor body
 - UK local authorities
 - any institution approved for investments (see below)
 - any other bank or building society authorised to operate in the UK
 - UK public and private sector pension funds (except Cheshire Pension Fund)
 - capital market bond investors
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
 - European Investment Bank

- 4.8 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- operating and finance leases
 - hire purchase
 - Private Finance Initiative
 - sale and leaseback
- 4.9 The Authority has previously raised the majority of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.
- 4.10 **LGA Bond Agency:** Local Capital Finance Company was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report.
- 4.11 **LOBO's:** The Authority holds £17m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS have options during 2016/17, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.
- 4.12 **Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.
- 4.13 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

5. Investment Strategy

- 5.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £40m and £92m. Slightly reduced levels are expected to be maintained in the forthcoming year.
- 5.2 Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.
- 5.3 Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2016/17. This is especially the case for the estimated £20m that is available for longer-term investment. The majority of the Authorities

surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. This diversification will therefore represent a continuation of the new strategy adopted in 2015/16.

- 5.4 The Authority may invest its surplus funds with any of the counterparties in table 2 below, subject to the cash and time limits shown.

Table 2: Approved Investment Counterparties and Limits

Credit Rating	Banks* Unsecured	Banks* Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£6m 5 years	£12m 20 years	£12m 50 years	£6m 20 years	£6m 20 years
AA+	£6m 5 years	£12m 10 years	£12m 25 years	£6m 10 years	£6m 10 years
AA	£6m 4 years	£12m 5 years	£12m 15 years	£6m 5 years	£6m 10 years
AA-	£6m 3 years	£12m 4 years	£12m 10 years	£6m 4 years	£6m 10 years
A+	£6m 2 years	£12m 3 years	£6m 5 years	£6m 3 years	£6m 5 years
A	£6m 13 months	£12m 2 years	£6m 5 years	£6m 2 years	£6m 5 years
A-	£6m 6 months	£12m 13 months	£6m 5 years	£6m 13 months	£6m 5 years
BBB+	£3m 100 days	£6m 6 months	£3m 2 years	£3m 6 months	£3m 2 years
BBB	£3m next day only	£6m 100 days	n/a	n/a	n/a
None	£1m 6 months	n/a	£10m 25 years	£50,000 5 years	£6m 5 years
Pooled funds	£12m per fund				

*Banks includes Building Societies

The above limits apply to individual counterparties and represent the maximum amount and maximum duration of any investment per counterparty.

- 5.5 **Credit Rating:** Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.
- 5.6 **Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB are restricted to overnight deposits at the Authority's current account bank, Barclays Bank.
- 5.7 **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

- 5.8 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
- 5.9 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.
- 5.10 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed.
- 5.11 **Pooled Funds:** Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
- 5.12 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.
- 5.13 **Risk Assessment and Credit Ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
- 5.14 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.
- 5.15 **Other Information on the Security of Investments:** The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

- 5.16 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.
- 5.17 **Specified Investments:** The CLG Guidance defines specified investments as those:
- denominated in pound sterling,
 - due to be repaid within 12 months of arrangement,
 - not defined as capital expenditure by legislation, and
 - invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of "high credit quality".
- 5.18 The Authority defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.
- 5.19 **Non-specified Investments:** Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£40m
Total investments without credit ratings or rated below A-	£25m
Total investments (except pooled funds) domiciled in foreign countries rated below AA+	£15m
Total non-specified investments	£80m

- 5.20 **Investment Limits:** The Authority's revenue reserves available to cover investment losses are forecast to be £61m on 31st March 2016. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £12m. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts (*e.g. King & Shaxson*), foreign countries and industry sectors as below:

Table 4: Investment Limits

Type of Counterparty	Cash limit
Any single organisation, except the UK Central Government	£12m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£12m per group
Any group of pooled funds under the same management	£25m per manager
Negotiable instruments held in a broker's nominee account	£35m per broker
Foreign countries	£12m per country
Registered Providers	£25m in total
Unsecured investments with Building Societies	£12m in total
Loans to unrated corporates	£12m in total
Money Market Funds	£12m in each (£50m in total)

- 5.21 **Liquidity management:** The Authority maintains a cash flow forecasting model to determine the maximum period for which funds may prudently be committed. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

6. Treasury Management Indicators

- 6.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.
- 6.2 **Interest Rate Exposures:** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2016/17	2017/18	2018/19
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	100%	100%	100%

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

- 6.3 **Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	35%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	35%	0%
5 years and within 10 years	50%	0%
10 years and within 20 years	100%	0%
20 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment

- 6.4 **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2016/17	2017/18	2018/19
Limit on principal invested beyond year end	£40m	£25m	£15m

7. Other Items

- 7.1 There are a number of additional items that the Authority is obliged by CIPFA or CLG to include in its Treasury Management Strategy.
- 7.2 **Policy on Use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
- 7.3 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
- 7.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
- 7.5 **Investment Advisers:** The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled by through regular meetings and periodic tendering for services.
- 7.6 **Investment Training:** The needs of the Authority's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by our treasury management advisers, Arlingclose Limited and other relevant providers.
- 7.7 **Investment of Money Borrowed in Advance of Need:** The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

- 7.8 The total amount borrowed will not exceed the authorised borrowing limit of £370 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

8. Financial Implications

- 8.1 Anticipated investment income in 2016/17 is £0.4 million, based on an average investment portfolio of £40 million at an interest rate of 1.00%. The budget for debt interest paid in 2016/17 is £4.1 million, based on an average debt portfolio of £106 million at an average interest rate of 3.9%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Annex A - Arlingclose Economic & Interest Rate Forecast

Underlying assumptions:

- UK economic growth softened in Q3 2015 but remained reasonably robust; the first estimate for the quarter was 0.5% and year-on-year growth fell slightly to 2.3%. Negative construction output growth offset fairly strong services output, however survey estimates suggest upwards revisions to construction may be in the pipeline.
- Household spending has been the main driver of GDP growth through 2014 and 2015 and remains key to growth. Consumption will continue to be supported by real wage and disposable income growth.
- Annual average earnings growth was 3.0% (including bonuses) in the three months to August. Given low inflation, real earnings and income growth continue to run at relatively strong levels and could feed directly into unit labour costs and households' disposable income. Improving productivity growth should support pay growth in the medium term. The development of wage growth is one of the factors being closely monitored by the MPC.
- Business investment indicators continue to signal strong growth. However the outlook for business investment may be tempered by the looming EU referendum, increasing uncertainties surrounding global growth and recent financial market shocks.
- Inflation is currently very low and, with a further fall in commodity prices, will likely remain so over the next 12 months. The CPI rate is likely to rise towards the end of 2016.
- China's growth has slowed and its economy is performing below expectations, which in turn will dampen activity in countries with which it has close economic ties; its slowdown and emerging market weakness will reduce demand for commodities. Other possible currency interventions following China's recent devaluation will keep sterling strong against many global currencies and depress imported inflation.
- Strong US labour market data and other economic indicators suggest recent global turbulence has not knocked the American recovery off course. Although the timing of the first rise in official interest rates remains uncertain, a rate rise by the Federal Reserve seems significantly more likely in December given recent data and rhetoric by committee members.
- Longer term rates will be tempered by international uncertainties and weaker global inflation pressure.

Forecast:

- Arlingclose forecasts the first rise in UK Bank Rate in Q3 2016. Further weakness in inflation, and the MPC's expectations for its path, suggest policy tightening will be pushed back into the second half of the year. Risks remain weighted to the downside. Arlingclose projects a slow rise in Bank Rate, the appropriate level of which will be lower than the previous norm and will be between 2 and 3%.
- The projection is for a shallow upward path for medium term gilt yields, with continuing concerns about the Eurozone, emerging markets and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued.
- The uncertainties surrounding the timing of UK and US monetary policy tightening, and global growth weakness, are likely to prompt short term volatility in gilt yields.

	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
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.25	-1.25
3-month LIBID rate													
Upside risk	0.20	0.30	0.30	0.30	0.35	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.55	0.60	0.70	0.80	0.95	1.05	1.15	1.30	1.40	1.55	1.65	1.80	1.85
Downside risk		-0.20	-0.30	-0.45	-0.55	-0.65	-0.80	-0.90	-1.05	-1.10	-1.20	-1.20	-1.20
1-yr LIBID rate													
Upside risk	0.25	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.45
Arlingclose Central Case	1.10	1.20	1.35	1.45	1.55	1.70	1.80	1.95	2.00	2.10	2.15	2.15	2.15
Downside risk	-0.15	-0.25	-0.35	-0.50	-0.60	-0.70	-0.85	-0.95	-1.10	-1.15	-1.25	-1.25	-1.25
5-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	1.50	1.55	1.60	1.70	1.80	1.90	2.00	2.10	2.20	2.25	2.30	2.35	2.35
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
10-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.00	2.05	2.10	2.20	2.30	2.40	2.50	2.60	2.65	2.70	2.75	2.80	2.80
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
20-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	2.95
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.65	-0.75	-0.85	-0.95	-1.05	-1.10	-1.15	-1.20	-1.20
50-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	3.00	3.00
Downside risk	-0.25	-0.35	-0.45	-0.50	-0.60	-0.70	-0.80	-0.90	-1.00	-1.05	-1.10	-1.15	-1.15

Annex B

Existing Investment & Debt Portfolio Position

	31/12/15 Actual Portfolio £m	31/12/15 Average Rate %
External Borrowing:		
PWLB - Fixed Rate	92	3.69%
PWLB - Variable Rate	0	-
Local Authorities	0	-
LOBO Loans	17	4.63%
Total External Borrowing	109	3.83%
Other Long Term Liabilities:		
PFI	25	-
Finance Leases	5	-
Total Gross External Debt	139	-
Investments:		
<i>Managed in-house</i>		
Short-term investments:		
Instant Access	10	0.38%
Notice Accounts	3	0.75%
Fixed Term Deposits	20	0.63%
Certificates of Deposit	5	0.70%
Covered Bonds	9	0.80%
Corporate Bonds	8	0.95%
Long-term investments	2	1.00%
<i>Managed externally</i>		
Fund Managers	4	0.61%
Property Funds	8	4.94%
Total Investments	69	1.15%
Net Debt	70	-

Annex C

Prudential Indicators revisions to 2015/16 and 2016/17 - 2018/19

1. Background:

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

The key feature of the prudential system is that councils should determine the level of their capital investment - and how much they borrow to finance that investment - based on their own assessment of what they can afford, not just for the current year but also for future years.

Individual authorities are responsible for deciding the level of their affordable borrowing. Prudential limits apply to all borrowing, qualifying credit arrangements and other long-term liabilities - whether supported by government or entirely self-financed. The system is designed to encourage authorities that need and can afford to undertake capital investment to do so.

In considering the affordability of its capital plans, the authority is required to consider all of the resources currently available to it/estimated for the future, together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the following two years. The authority is also required to consider known significant variations beyond this timeframe.

2. Gross Debt and the Capital Financing Requirement:

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with **gross** external debt.

The Chief Operating Officer reports that the Authority had no difficulty meeting this requirement in 2015/16, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3. Estimates of Capital Expenditure:

- 3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Expenditure	2015/2016	2016/2017	2017/2018	2018/2019	Future years
	Estimate £m	Estimate £m	Estimate £m	Estimate £m	Estimate £m
Total	109.6	183.7	148.0	115.7	34.5

Source: Cheshire East Finance

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	2015/2016 Estimate £m	2016/2017 Estimate £m	2017/2018 Estimate £m	2018/2019 Estimate £m	Future years Estimate £m
Capital receipts	17.0	41.0	21.0	27.4	12.3
Government Grants	30.3	51.9	63.2	73.7	8.1
External Contributions	14.5	6.7	13.0	14.6	14.1
Revenue Contributions	3.8	0.7	0.0	0.0	0.0
Total Financing	65.6	100.3	97.2	115.7	34.5
Prudential Borrowing	44.0	83.4	50.8	0.0	0
Total Funding	44.0	83.4	50.8	0.0	0.0
Total Financing and Funding	109.6	183.7	148.0	115.7	34.5

Source: Cheshire East Finance

4. Ratio of Financing Costs to Net Revenue Stream:

4.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

4.2 The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2015/2016 Estimate %	2016/2017 Estimate %	2017/2018 Estimate %	2018/2019 Estimate %
Total	5.58	5.55	5.44	5.48

Source: Cheshire East Finance

5. Capital Financing Requirement:

5.1 The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and financing.

Capital Financing Requirement	2015/2016 Estimate £m	2016/2017 Estimate £m	2017/2018 Estimate £m	2018/2019 Estimate £m
Total	248	310	377	359

6. Actual External Debt:

- 6.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2015		£m
Borrowing		115
Other Long-term Liabilities		31
Total		146

Source: Cheshire East Finance

7. Incremental Impact of Capital Investment Decisions:

- 7.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2016/2017 Estimate	2017/2018 Estimate	2018/2019 Estimate
	£	£	£
Band D Council Tax	23.51	26.72	0

Source: Cheshire East Finance

8. Authorised Limit and Operational Boundary for External Debt:

- 8.1 The Authority has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Authority and not just those arising from capital spending reflected in the CFR.
- 8.2 The **Authorised Limit** sets the maximum level of external debt on a gross basis (i.e. excluding investments) for the Authority. It is measured on a daily basis against all external debt items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Authority's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.
- 8.3 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).
- 8.4 The Operational Boundary has been set on the estimate of the most likely, i.e. prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.
- 8.5 The Operational Boundary links directly to the Authority's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as

the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

	2015/2016 Estimate £m	2016/2017 Estimate £m	2017/2018 Estimate £m	2018/2019 Estimate £m
Authorised Limit for Borrowing	260	320	390	370
Authorised Limit for Other Long-Term Liabilities	30	28	27	25
Authorised Limit for External Debt	290	348	417	395
Operational Boundary for Borrowing	250	310	380	360
Operational Boundary for Other Long- Term Liabilities	30	28	27	25
Operational Boundary for External Debt	280	338	407	385

Source: Cheshire East Finance

9. Adoption of the CIPFA Treasury Management Code:

9.1 This indicator demonstrates that the Authority has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management

The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 23rd February 2012

The Authority has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

10.1 These indicators allow the Authority to manage the extent to which it is exposed to changes in interest rates. This Authority calculates these limits on net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments).

10.2 The upper limit for variable rate exposure has been set to ensure that the Authority is not exposed to interest rate rises which could adversely impact on the revenue budget.

The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments

	Existing level (or Benchmark level) at 10/12/15 %	2015/2016 Approved	2015/2016 Revised	2016/2017 Estimate	2017/2018 Estimate	2018/2019 Estimate
		%	%	%	%	%
Upper Limit for Fixed Interest Rate Exposure	100%	100%	100%	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure	0%	100%	100%	100%	100%	100%

Source: Cheshire East Finance

10.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Authority's treasury management strategy.

11. Maturity Structure of Fixed Rate borrowing:

11.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

11.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

11.3 LOBOs are classified as maturing on the next call date i.e. the earliest date that the lender can require repayment. As all LOBOs are can be called within 12 months the upper limit for borrowing maturing within 12 months is relatively high to allow for the value of LOBOs and any potential short term borrowing that could be undertaken in 2016/17.

Maturity structure of fixed rate borrowing	Level as at 31 st March 2016(based on Current Borrowing) %	Lower Limit for 2016/2017 %	Upper Limit for 2016/2017 %
under 12 months	24%	0%	35%
12 months and within 24 months	6%	0%	25%
24 months and within 5 years	14%	0%	35%
5 years and within 10 years	1%	0%	50%
10 years and within 20 years	24%	0%	100%
20 years and within 30 years	7%	0%	100%
30 years and within 40 years	17%	0%	100%
40 years and within 50 years	7%	0%	100%
50 years and above	0%	0%	100%

12. Credit Risk:

- 12.1 The Authority considers security, liquidity and yield, in that order, when making investment decisions.
- 12.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Authority's assessment of counterparty credit risk.
- 12.3 The Authority also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:
- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
 - Sovereign support mechanisms;
 - Credit default swaps (where quoted);
 - Share prices (where available);
 - Economic fundamentals, such as a country's net debt as a percentage of its GDP;
 - Corporate developments, news, articles, markets sentiment and momentum;
 - Subjective overlay.
- 12.4 The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

Annex D - MRP Statement 2016/17

The annual Minimum Revenue Provision (MRP) Statement sets out the Council's responsibility to ensure it makes adequate provision for funding the consequences of its capital investment decisions.

Capital expenditure is expenditure that provides ongoing benefits to the Council for a period of longer than 1 year. Accounting rules require that where this capital expenditure is not funded through external contributions, external grants, capital receipts or contributions from revenue budgets it must be charged against the Council's General Fund Balances. The period over which this charge is made should reflect the length of time that the expenditure will provide benefits to the Council.

CLG's Guidance on Minimum Revenue Provision (issued in 2010) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

Prior to 2010 the major proportion of MRP relates to the more historic debt liability that was outstanding at the time the Guidance was adopted. This will continue to be charged at the rate of 4%, in accordance with option 1 of the Guidance.

New capital expenditure for each subsequent year will in general be charged in accordance with Option 3 of the Guidance, which recommends that the annual charge should broadly equate to the anticipated life, or period of benefit, which is reflective of the nature of the expenditure. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

Charges will commence in the year following the creation of the capital asset, i.e, in the assets first full year of operation.

In the case of long term debtors arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements, there will be no minimum revenue provision made.

For those types of capital expenditure incurred by the Council which are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure.

MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

The MRP Statement will be submitted to Council before the start of the 2016/17 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement will be put to Council at that time.