Joint Strategic Committee
2nd February, 2016
Agenda Item No: 6

Joint Governance
22nd March, 2016
Agenda Item No: xx
Ward: All

JOINT TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2016/17 TO 2018/19 ADUR DISTRICT COUNCIL AND WORTHING BOROUGH COUNCIL

REPORT BY DIRECT OF DIGITAL AND RESOURCES

1.0 INTRODUCTION

1.1 Background

The Councils are required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in high quality counterparties or instruments commensurate with the Councils' low risk appetite, providing adequate liquidity initially, before considering investment return. This is consistent with national guidance which promotes security and liquidity above yield.

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

CIPFA defines treasury management 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 Reporting requirements

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

Prudential and treasury indicators and treasury strategy (this report), to be approved by the Joint Strategic Committee (JSC)- the first, and most important report covers:

1.0 INTRODUCTION

1.2 Reporting requirements

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be scrutinised by the Joint Governance Committee (JGC) which may make recommendations to the JSC regarding any aspects of Treasury Management policy and practices it considers appropriate in fulfilment of its scrutiny role. Such recommendations as may be made shall be incorporated within the above named reports and submitted to meetings of the JSC for consideration as soon after the meetings of the JGC as practically possible.

1.3 Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Councils;
- prospects for interest rates;
- the borrowing strategy;

1.0 INTRODUCTION

1.3 Treasury Management Strategy for 2016/17

<u>Treasury management issues</u>

- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training is arranged as required.

The training needs of treasury management officers are periodically reviewed and officers attend courses provided by appropriate trainers.

1.5 Treasury management consultants

The Councils last undertook a joint re-tender for treasury management consultancy services in the autumn of 2013. This culminated in the re-appointment of the Councils' incumbent consultants, Capita Treasury Solutions Limited (formerly known as Capita Asset Services Limited) on similar terms and for a three year period ending 31 October 2016. The contract will be re-procured in the current year.

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

They 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 Councils will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

The Councils' capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

2.1 Capital expenditure

This prudential indicator is a summary of the Councils' capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts.

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

ADUR DISTRICT COUNCIL

Capital expenditure	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**	**£m**
Non-HRA	3.456	6.377	*9.830	*5.818	*5.298
HRA	3.749	4.136	5.686	4.154	4.214
TOTAL	**7.205**	**10.513**	**15.516**	**10.972**	**10.512**
Financed by:					
Capital receipts	-	0.772	0.546	0.406	0.406
Capital grants and contributions	0.698	2.171	4.325	0.772	0.252
Reserves and contributions	4.237	3.882	5.377	3.800	3.860
Net financing need for the year	**2.270**	**3.688**	**5.268**	**5.994**	**5.994**

***The capital expenditure includes the amounts allocated to the Strategic Property Fund - £2m in 2016/17, £5m in 2017/18 and £5m in 2018/19**

WORTHING BOROUGH COUNCIL

Capital expenditure	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**	**£m**
Non-HRA	**3.303**	4.963	*20.073	*7.242	*6.939
Financed by:					
Capital receipts	1.343	0.225	0.369	0.500	0.500
Capital grants and contributions	0.715	0.937	1.037	0.530	0.493
Reserves and contributions	0.341	0.296	0.273	0.160	0.160
Net financing needed for the year	**0.904**	**3.505**	**18.394**	**6.052**	**5.786**

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

***The capital expenditure includes a £10m loan to a local Registered Social Landlord in 2016/17 and the amounts allocated to the Strategic Property Fund - £2m in 2016/17, £5m in 2017/18 and £5m in 2018/19.**

2.2 The Councils' borrowing need (the Capital Financing Requirement)

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

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life. The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Councils' borrowing requirement, these types of scheme include a borrowing facility and so the Councils are not required to separately borrow for these schemes.

The Councils are asked to approve the CFR projections below:

ADUR DISTRICT COUNCIL

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**	**£m**
Capital Financing Requirement					
CFR – non-HRA	12.449	15.195	19.282	23.982	28.593
CFR – HRA	63.536	61.820	60.102	58.386	56.669
Total CFR	**75.985**	**77.015**	**79.384**	**82.368**	**85.262**
Movement in CFR	**(0.298)**	**1.030**	**2.369**	**2.984**	**2.894**
Movement in CFR represented by					
Net financing need for the year (above)	2.270	3.688	5.268	5.994	5.994
Less: MRP/VRP and other financing movements	(2.568)	(2.658)	(2.899)	(3.010)	(3.100)
Movement in CFR	**(0.298)**	**1.030**	**2.369**	**2.984**	**2.894**

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

2.2 The Councils' borrowing need (the Capital Financing Requirement)

WORTHING BOROUGH COUNCIL

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	£m	£m	£m	£m
Capital Financing Requirement					
CFR – non housing	**23.585**	**25.940**	**42.944**	**47.527**	**51.769**
Movement in CFR	**(0.174)**	**2.355**	**17.004**	**4.583**	**4.242**
Movement in CFR represented by					
Net financing need for the year (above)	0.904	3.505	18.394	6.052	5.786
Less MRP/VRP and other financing movements	(1.078)	(1.150)	(1.390)	(1.469)	(1.544)
Movement in CFR	**(0.174)**	**2.355**	**17.004**	**4.583**	**4.242**

2.3 Minimum revenue provision (MRP) policy statement

The Councils are required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP). CLG regulations have been issued which require the full Councils to approve an MRP Statement in advance of each year. The 2015/16 MRP Statements were approved by Adur Council on 19th February 2015 and by Worthing Council on 17th February.

A variety of options are provided to councils, so long as there is a prudent provision. The Councils are recommended to approve the following MRP Statements:

<u>Adur District Council</u>
For Adur Council it was first approved by the Policy and Strategy Committee on 18th March 2008 that for capital expenditure incurred before 1st April 2008, the MRP will be calculated on 4% of the Non-Housing CFR at the closing balance of the previous financial year (ie no "Adjustment A" to negate the impact on Council Tax – the CFR Method). No such policy was required by Worthing Borough Council who had no debt at this time.

For non-HRA capital expenditure after 1st April 2008 the MRP will be calculated as the annual amount required to repay borrowing in equal instalments over the life of the assets acquired, although the option remains to use additional revenue contributions or capital receipts to repay debt earlier (the Asset Life Method).

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

2.3 Minimum revenue provision (MRP) policy statement

An exception was agreed in the 2015/16 Treasury Management Strategy Statement: the Chief Financial Officer has discretion to defer MRP relating to debt arising from loans to Registered Social Landlords (RSLs) to match the profile of debt repayments from the RSL. RSLs normally prefer a maturity type loan as it matches the onset of income streams emanating from capital investment with the timing of the principal debt repayment. The deferral of MRP to the maturity date would therefore mean that MRP is matched at the same point as the debt is repaid, and is therefore cash (and revenue cost) neutral to the Council.

If concerns arise about the ability of the RSL to repay the loan, the Chief Financial Officer will use the approved discretion to make MRP as a "prudent provision" from the earliest point to ensure that sufficient funds are set aside from revenue to repay the debt at maturity if the RSL defaults.

It is proposed to use the same policy for 2016/17.

The Adur HRA debt at the beginning of 2012/13 was close to the Government's imposed debt limit of £68.912m. The Council is not permitted to borrow in excess of this amount for HRA purposes. The Council's MRP policy therefore applies the financially prudent option of voluntary MRP for the repayment of HRA debt, to facilitate new borrowing in future for capital investment. It is proposed to continue with this approach for 2016/17 and to make annual MRP for a period of 40 years on all HRA debt, being the estimated life of the Council Housing Stock. Usually, MRP is applied in the financial year following the drawdown of debt. For HRA purposes, as the MRP is voluntary, it is proposed that where debt is obtained to fund new house building, MRP be applied from the year in which the housing provided is brought into service. This will align the period in which the income streams arising from the new homes are generated with the period when MRP commences. MRP will be provided by a transfer from the HRA.

Worthing Borough Council

Worthing's 2015/16 MRP policy also approved the use of the Asset Life Method in respect of all new supported and unsupported borrowing, but with the same discretion as for Adur Council in the application of MRP in respect of loans to RSLs. It is proposed to retain this policy for 2016/17.

If any finance leases are entered into the repayments are applied as MRP.

2.4 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Councils' overall finances. The Councils are asked to approve the following indicators:

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

2.5 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

ADUR DISTRICT COUNCIL

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	%	%	%	%	%
Non-HRA	15.46	16.34	17.25	19.42	20.40
HRA	42.93	42.12	41.00	44.23	45.11

WORTHING BOROUGH COUNCIL

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	%	%	%	%	%
Non-HRA	8.16	9.01	11.56	12.43	13.17

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

2.6 Incremental impact of capital investment decisions on Council Tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Councils' existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Incremental impact of capital investment decisions on the band D Council Tax

ADUR DISTRICT COUNCIL

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£	£	£	£	£
Council Tax - Band D	5.34	4.96	12.75	3.72	4.09

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

WORTHING BOROUGH COUNCIL

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£	£	£	£	£
Council Tax - Band D	5.47	4.32	10.56	3.19	3.62

2.7 **Estimates of the incremental impact of capital investment decisions on housing rent levels**

Similar to the Council Tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Adur District Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Incremental impact of capital investment decisions on housing rent levels

ADUR DISTRICT COUNCIL

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£	£	£	£	£
Weekly housing rent levels	(0.44)	(0.46)	(0.25)	(0.44)	(0.32)

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

3.0 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Councils. The treasury management function ensures that the Councils' cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.0 BORROWING

3.1 Current portfolio position

The Councils' treasury portfolio positions at 31 March 2015, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing. The increase in debt includes £10m in 2016/17 for Worthing Homes and £5m in 2017/18 for each Council for investment in the property fund.

ADUR DISTRICT COUNCIL

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**	**£m**
External Debt					
Debt at 1 April	78.209	75.986	74.268	72.549	75.843
Expected change in Debt	(2.223)	(1.718)	(1.719)	3.294	(1.706)
Other long-term liabilities (OLTL)	-	-	-	-	-
Expected change in OLTL	-	-	-	-	-
Actual gross debt at 31 March	**75.986**	**74.268**	**72.549**	**75.843**	**74.137**
The Capital Financing Requirement	**75.985**	**77.015**	**79.384**	**82.368**	**85.262**
Under / (over) borrowing	**(0.001)**	**2.747**	**6.835**	**6.525**	**11.125**

WORTHING BOROUGH COUNCIL

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**	**£m**
External Debt					
Debt at 1 April	14.722	18.088	19.136	28.350	32.600
Expected change in Debt	3.366	1.048	9.214	4.250	(0.750)
Other long-term liabilities (OLTL)	-	-	-	-	-
Expected change in OLTL	-	-	-	-	-
Actual gross debt at 31 March	**18.088**	**19.136**	**28.350**	**32.600**	**31.850**
The Capital Financing Requirement	**23.585**	**25.940**	**42.944**	**47.527**	**51.769**
Under / (over) borrowing	**5.497**	**6.804**	**14.594**	**14.927**	**19.919**

3.0 BORROWING

3.1 Current portfolio position

Within the prudential indicators there are a number of key indicators to ensure that the Councils operate their activities within well-defined limits. One of these is that the Councils need to ensure that their gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Financial Officer reports that the Councils complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary - This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

ADUR DISTRICT COUNCIL

Operational boundary	2015/16 Approved	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**
Debt	93.0	93.0	93.0	93.0
Other long term liabilities	1.0	1.0	1.0	1.0
Total	**94.0**	**94.0**	**94.0**	**94.0**

WORTHING BOROUGH COUNCIL

Operational boundary	2015/16 Approved	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**
Debt re Worthing Homes	0.0	10.0	10.0	10.0
Other Debt	29.0	29.0	29.0	29.0
Other long term liabilities	1.0	1.0	1.0	1.0
Total	30.0	40.0	40.0	40.0

The authorised limit for external debt - A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Councils. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

3.0 BORROWING

3.2 Treasury Indicators: limits to borrowing activity

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

2. The Councils are asked to approve the following authorised limits:

ADUR DISTRICT COUNCIL

Authorised limit	2015/16 Approved	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**
Debt	99.0	99.0	99.0	99.0
Other long term liabilities	1.0	1.0	1.0	1.0
Total	**100.0**	**100.0**	**100.0**	**100.0**

WORTHING BOROUGH COUNCIL

Authorised limit	2015/16 Approved	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**
Debt re Worthing Homes	0.0	10.0	10.0	10.0
Other Debt	34.0	34.0	34.0	34.0
Other long term liabilities	1.0	1.0	1.0	1.0
Total	**35.0**	**45.0**	**45.0**	**45.0**

Separately, Adur District Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit	2015/16 Approved	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£m	**£m**	**£m**	**£m**
HRA debt cap	68.912	68.912	68.912	68.912
HRA CFR	61.820	60.102	58.386	56.669
HRA headroom	7.092	8.810	10.526	12.243

3.3 Prospects for interest rates

The Councils have appointed Capita Asset Services as their treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

3.0 BORROWING

3.3 Prospects for interest rates

	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	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%
5yr PWLB rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%

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 this year. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have distinctly weakened and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

The Inflation Report was notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1 percent in the second half of 2016. 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. There is considerable uncertainty around how quickly 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.

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 weakened again to 1.5% in quarter 3. The run of strong monthly increases in nonfarm payroll figures for growth in employment in 2015 has prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

3.0 BORROWING

3.3 Prospects for interest rates

EZ. In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €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 a significant 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 looks as if it may maintain this pace in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

- Investment returns are likely to remain relatively low during 2016/17 and beyond;

- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenominally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

3.4 Borrowing Strategy

The Councils are both currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt, as cash supporting the Councils' reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are currently lower than the cost of borrowing and reflects current views on counterparty risks.

3.0 BORROWING

3.4 **Borrowing strategy**

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

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.5 Both Councils will refer in the first instance to the Public Works Loan Board (PWLB) for sourcing their borrowing needs, given that they are eligible to access the PWLB "Certainty" rate of interest, being 20 basis points below the normal prevailing PWLB rates. However, borrowing from other sources, including other Councils and the Local Government Association Municipal Bonds Agency (see para 3.10), may from time to time offer options to borrow more cheaply than from the PWLB, and therefore will be considered.

Given the expected under borrowing position of the Councils, the borrowing strategy will give consideration to new borrowing in the following order of priority:-

i) Internal borrowing, by running down cash balances and foregoing interest earned at historically low rates, as this is the cheapest form of borrowing;

ii) Weighing the short term advantage of internal borrowing against potential long term borrowing costs, in view of the overall forecast for long term borrowing rates to increase over the next few years;

iii) PWLB variable rate loans for up to 10 years;

iv) Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB, market debt and loans from other councils in the debt portfolio;

v) PWLB borrowing for periods under 5 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt**.**

3.0 BORROWING

3.6 Preference will be given to PWLB borrowing by annuity and EIP loans instead of maturity loans, as this may result in lower interest payments over the life of the loans.

3.7 **Treasury management limits on activity**

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure of borrowing. These gross limits are set to reduce the Councils' exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Councils are asked to approve the following treasury indicators and limits:

ADUR DISTRICT COUNCIL

Interest rate exposures	2016/17	2017/18	2018/19
	Upper **%**	**Upper** **%**	**Upper** **%**
Limits on fixed interest rates – debt only	100	100	100
Limits on fixed interest rates – Investments only	100	100	100
Estimate of fixed interest on net debt	84	84	83
Limits on variable interest rates – debt only	50	50	50
Limits on variable interest rates - Investments only	100	100	100
Estimate of variable interest on net debt	16	16	17

3.0 BORROWING

3.7 Treasury management limits on activity

ADUR DISTRICT COUNCIL

Maturity structure of fixed interest rate borrowing 2016/17		
	Lower	**Upper**
Under 12 months	2%	17%
12 months to 2 years	2%	17%
2 years to 5 years	7%	21%
5 years to 10 years	14%	28%
10 years to 20 years	23%	37%
20 years to 30 years	14%	28%
30 years to 40 years	7%	22%
40 years to 51 years	31%	31%

WORTHING BOROUGH COUNCIL

Interest rate exposures	2016/17	2017/18	2018/19
	Upper %	**Upper %**	**Upper %**
Limits on fixed interest rates – debt only	100	100	100
Limits on fixed interest rates – Investments only	100	100	100
Estimate of fixed interest on net debt	100	100	100
Limits on variable interest rates – debt only	25	25	25
Limits on variable interest rates - Investments only	100	100	100
Estimate of variable interest on net debt	0	0	0

3.0 BORROWING

3.7 Treasury management limits on activity

Maturity structure of fixed interest rate borrowing 2016/17		
	Lower	**Upper**
Under 12 months	62%	62%
12 months to 2 years	4%	4%
2 years to 5 years	21%	21%
5 years to 10 years	13%	13%

3.8 Policy on borrowing in advance of need

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

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

3.9 Debt rescheduling

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

The reasons for any rescheduling to take place will include:

- the generation of cash savings and/or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancement of the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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

75% of Adur’s debt portfolio consists of long term loans with an average maturity of 40 years left to run, and at rates above prevailing market rates for equivalent loans. The cost to redeem these loans early would incur a debt premium (at current estimates) of some £10m, and is unaffordable.

3.0 BORROWING

3.9 Debt rescheduling

By contrast, only 13% of Worthing's existing fixed rate debt portfolio is for over 5 years, so options for early settlement do not really apply.

All rescheduling will be reported to the Councils at the earliest meeting following its action

3.10 Municipal Bond Agency

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

4.0 ANNUAL INVESTMENT POLICY AND STRATEGY 2016/17

Background - Investment Policy

4.1 The Councils' 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 Councils' investment priorities will be security first, liquidity second, then return.

4.2 The CLG's revised Guidance on investments reiterates security and liquidity as the primary objectives of a prudent investment policy. The speculative procedure of borrowing purely in order to invest is unlawful.

4.3 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Potential instruments for the Councils' use within its investment strategy are contained in Appendix A.

4.4 The credit crisis has refocused attention on the treasury management priority of security of capital monies invested. The Councils will continue to maintain a counterparty list based on the approved criteria and will monitor and update the credit standing of the institutions on a regular basis. This assessment will include credit ratings and other alternative assessments of credit strength as outlined in paragraphs 4.5 - 4.16.

Creditworthiness Policy

4.5 The Councils use the creditworthiness service provided by Capita Treasury Solutions Limited. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

4.0 ANNUAL INVESTMENT POLICY AND STRATEGY 2016/17

Creditworthiness Policy

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

4.6 The modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is combined with an overlay of CDS spreads. The result is a series of colour code bands for counterparties indicating the relative creditworthiness of each as they are categorised by durational bands. These bands are used by the Councils to form a view of the duration for investments by each counterparty. The Councils are satisfied that this service gives a robust level of analysis for determining the security of its investments. It is also a service which the Councils would not be able to replicate using its own in-house resources.

4.7 The selection of counterparties with a high level of creditworthiness will be achieved by reference to the minimum durational band proposed by Capita's weekly credit list of worldwide potential counterparties. The Councils will consider, but not necessarily adhere rigidly to (see paras.4.10-4.11), the categorised counterparties within the following durational bands*: -*

- Yellow (Y) 5 years *
- Dark pink (Pi1) 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink (Pi2) 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple (P) 2 years
- Blue (B) 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange (O) 1 year
- Red (R) 6 months
- Green (G) 100 days **
- No colour (N/C) not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	8	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

* The yellow colour category is for UK Government debt, or its equivalent, Constant Net Asset Value money market funds and collateralised deposits where the collateral is UK Government debt.

** The green limit was formerly for 3 months but in July 2013 the Financial Conduct Authority set a requirement for qualifying deposits for bank liquidity buffers of a minimum of 95 days so the green band has been slightly extended to accommodate this regulatory change.

4.0 ANNUAL INVESTMENT POLICY AND STRATEGY 2016/17

Creditworthiness Policy

4.8 Although the Capita creditworthiness service does use ratings from all three agencies, the practice of using a risk weighted scoring system eliminates any tendency to give undue preponderance to just one agency's ratings.

4.9 Using Capita's ratings service, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications. The effect of a change in ratings may prompt the following responses:

- If a downgrade results in the counterparty/investment scheme no longer meeting the Councils' minimum criteria, its further use as a new investment will be withdrawn immediately.

- In addition to the use of Credit Ratings the Councils will be advised by Capita of movements in Credit Default Swaps against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils' lending list.

4.10 The Councils' officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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, the government support for banks, and the credit ratings of that government support.

4.11 Accordingly, the Councils may exercise discretion to deviate from Capita's suggested durational bands for counterparties where sudden changes in financial markets, the banking sector, or other circumstances warrant a more flexible approach being taken.

The Councils' Minimum Investment Creditworthiness Criteria

4.12 The minimum credit ratings criteria the Councils use will be a short term rating (Fitch or equivalents) of F1, and long term rating A-. The Councils will no longer rely, as in previous years, on viability and support ratings of counterparties. The reason for this reflects the withdrawal of these ratings by the rating agencies as explained by Capita Treasury Solutions Limited. :

"Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes."

4.0 ANNUAL INVESTMENT POLICY AND STRATEGY 2016/17

The Councils' Minimum Investment Creditworthiness Criteria

4.13 There may be occasions when the counterparty ratings from one or more of the three Ratings Agencies are marginally lower than the minimum requirements of F1 Short term, A- Long term (or equivalent). Where this arises, the counterparties to which the ratings apply may still be used with discretion, but in these instances consideration will be given to the whole range of topical market information available, not just ratings.

Country Limits and Proposed Monitoring Arrangements

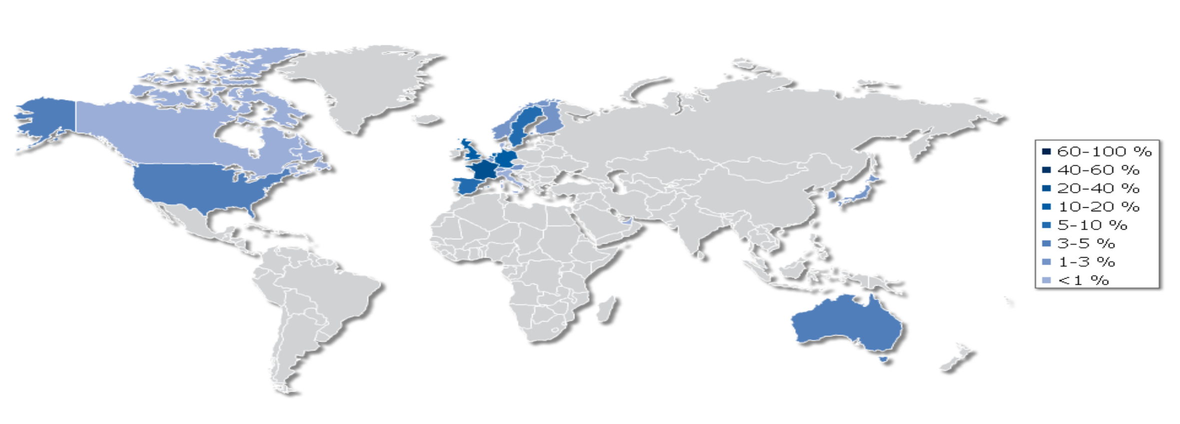
4.14 The Councils have determined that they will only use approved counterparties from countries with a minimum sovereign credit rating of *AA-* from Fitch Ratings (or equivalent from other agencies if Fitch does not provide one). The list of countries that qualify using these credit criteria is reflected in the Counterparty Approved Lending List shown at Appendix A. No more than 25% of investments shall be placed in Non-UK financial institutions at any given time.

4.15 The monitoring of the Councils' exposure to non-UK institutions is especially important in the present climate, particularly in respect of sovereign debt issues within Eurozone countries.

4.16 Although the Councils can control the foreign exposure for fixed term deposits via the choice of counterparties, the ability to do this for instant access Money Market Funds (MMFs) is more difficult, as the assets which comprise the funds generally consist of loans to other financial institutions (UK and worldwide).

4.17 Recognising the present financial climate, and that any investment is only as good as the underlying assets, the Councils shall use a Money Market Fund Portal for placing and redeeming transactions. This will allow access to information on the underlying composition of the MMFs, including the geographic spread of the underlying assets. A sample report showing underlying assets by Country is shown below:

Country Distribution



FR	France	25.41%	US	United States	3.64%	BE	Belgium	1.33%
GB	United Kingdom	14.70%	SG	Singapore	2.43%	NO	Norway	1.07%
DE	Germany	13.00%	CH	Switzerland	2.09%	JP	Japan	1.06%
NL	Netherlands	10.60%	KR	Korea, Republic Of (South)	2.00%	CA	Canada	0.51%
SE	Sweden	7.05%	FI	Finland	1.59%	IT	Italy	0.31%
ES	Spain	5.48%	LU	Luxembourg	1.55%	DK	Denmark	0.27%

4.0 ANNUAL INVESTMENT POLICY AND STRATEGY 2016/17

Country Limits and Proposed Monitoring Arrangements

4.18 The Interest Rate Outlook is summarised in 3.3 above. The Councils will avoid locking into longer term investments beyond 1 year duration while investment rates are down at historically low levels, unless attractive rates are available with counterparties of particularly high creditworthiness (i.e. other Councils or approved counterparties with a minimum credit rating of *AA-* from Fitch Ratings, or equivalent from other agencies if Fitch does not provide one) which make longer term deals worthwhile and within the risk parameters set by the Councils.

4.19 In-house funds - Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

4.20 Investment returns expectations - Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 of 2016. Bank Rate forecasts for financial year ends (March) are:

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

Investment Outlook

4.21 There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

4.22 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next three years are as follows:

2016/17	0.60%
2017/18	1.25%
2018/19	1.75%

4.23 Within the approach described in 4.18 above, total principal funds invested for greater than 364 days will be determined with regard to the Councils' liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds. The amounts invested greater than 364 days shall remain within the limit set for this purpose within the Treasury Management Prudential Indicator below.

4.0 ANNUAL INVESTMENT POLICY AND STRATEGY 2016/17

Investment Outlook

ADUR DISTRICT COUNCIL

MAXIMUM PROPORTION OF PRINCIPAL SUMS INVESTED > 364 DAYS			
	2016/17	**2017/18**	**2018/19**
Principal sums invested > 364 days	50%	50%	50%

WORTHING BOROUGH COUNCIL

MAXIMUM PROPORTION OF PRINCIPAL SUMS INVESTED > 364 DAYS			
	2016/17	**2017/18**	**2018/19**
Principal sums invested > 364 days	50%	50%	50%

Investments managed in-house

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

4.25 The Chief Financial Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the meetings of the JGC and JSC in accordance with the reporting arrangements contained in the Treasury Management Practices Statement.

4.26 In any sustained period of significant stress in the financial markets, the default position is for investments to be placed with The Debt Management Account Deposit Facility of the Debt Management Office (DMO) of the UK central government. The rates of interest are below equivalent money market rates, however, the returns are an acceptable trade-off for the guarantee that the Councils' capital is secure.

4.27 The Councils' proposed investment activity for placing cash deposits in 2016/17 is unchanged from the previous year and will be to use:

- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV).
- other local authorities.
- business reserve accounts and term deposits. These are primarily restricted to UK institutions that are rated at least A- long term.

4.0 ANNUAL INVESTMENT POLICY AND STRATEGY 2016/17

Investment Outlook

- institutions with a very high likelihood of support, including Royal Bank of Scotland, Lloyds, HSBC and Barclays.
- institutions with a moderate or high likelihood of support, including Santander UK.
- the top five building societies by asset size

Use of Building Societies

4.28 In recognition of the inclusion of the building society names and that they carry a lower credit rating than the Councils' other counterparties, the lending limits for the building societies shall be £2m each, excepting that for Nationwide (the top building Society) the lending limit shall be £4m – as it is also an institution with a moderate likelihood of support.

Impact of European Commission Proposals for Money Market Funds

4.29 The Councils use of Money Market Funds (MMFs) for short term investments of surplus cash provides instant liquidity with high quality counterparties at a return comparable to (if not better than) other fixed deposits of short term duration.

4.30 The funds used are "triple A" rated because of their sheer size, liquidity, and constant net asset value (CNAV), the latter of which means that typically for every pound of principal invested the Councils are assured of receiving one pound back. This is not guaranteed, but offers indications of better protection than using alternative MMFs which are based on a Variable Net Asset Value (VNAV). On this basis the underlying assets are priced on a daily market rate that is subject to change, and could result in a loss of principal (where say one pound invested one day is priced at less than one pound on another day).

4.31 While the Councils avoid the use of VNAV MMFs to mitigate the risk of exposure to incurring a capital loss, legislative changes proposed by the European Commission could result in the closure or withdrawal of CNAV MMFs in future. Among the proposals are the withdrawal of formal credit ratings (but not an opinion of credit worthiness) from the ratings agencies, and changing the valuation basis of the underlying funds such that existing CNAV MMFs indicate it would be impractical to continue.

4.32 Given that the Councils' overriding investment priority is "security of principal", in the event that the proposed changes are implemented, the Councils will desist from using MMFs if it is the case that they do not retain the CNAV basis of valuation, or that the triple A rating is withdrawn or replaced with a measure below the Councils' minimum criteria for short term investment.

4.0 ANNUAL INVESTMENT POLICY AND STRATEGY 2016/17

Use of Notice Accounts

4.33 Alongside the use of MMFs, the Councils will utilise Call or Notice Accounts offered by counterparties included within the Approved Counterparty Investment List. These accounts differ from MMFs in that deposits must reside in the accounts for a minimum duration, typically 60 or 95 days, although other durations or conditions may apply. Consideration will be given to the use of such accounts where they provide extra return over MMFs or fixed term deposits with banks and building societies meeting the Councils' short term investment criteria.

Other Options for Longer Term Investments

4.34 To provide the Councils with options to enhance returns above those available for short term durations, it is proposed to retain the option to use the following forms for longer term investments, as an alternative to cash deposits:

a) **Supranational bonds greater than 1 year to maturity**

(i) <u>Multilateral development bank bonds</u> - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.).

(ii) <u>A financial institution that is guaranteed by the United Kingdom Government</u> (e.g. National Rail, The Guaranteed Export Finance Company {GEFCO})

The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.

b) **Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.

c) **Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use the top five building societies by asset size up to £2m, (£4m Nationwide).

d) Any **bank or building society** that has a minimum long term credit rating of A- for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).

4.0 ANNUAL INVESTMENT POLICY AND STRATEGY 2016/17

Other Options for Longer term Investments

e) Any **non-rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to a guarantee from the parent company, and exposure up to the limit applicable to the parent.

f) **Registered Social Landlords** (Housing Associations) - subject to confirming the Councils have appropriate powers, consideration will be given to lending to Registered Social Landlords. Such lending may either be as an investment for treasury management purposes, or for the provision of "social policy or service investment", that would not normally feature within the Treasury Management Strategy.

Accounting treatment of investments

g) **Share capital** *in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies.*

h) **Loan capital** in a body corporate.

(Note: For (g) and (h) above the Councils will seek further advice on the appropriateness and associated risks with investments in these categories as and when an opportunity presents itself).

4.35 The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Councils. To ensure that the Councils are protected from any adverse revenue impact, which may arise from these differences, the accounting implications of new transactions will be reviewed before they are undertaken.

4.36 The Councils will not transact in any investment that may be deemed to constitute capital expenditure (e.g. Share Capital, or pooled investment funds other than Money Market Funds), without the resource implications being approved as part of the consideration of the Capital Programme or other appropriate Committee report.

5.0 BALANCED BUDGET REQUIREMENT

5.1 The Councils comply with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

6.0 OTHER MATTERS

Shared Services Arrangement with Mid Sussex District Council

6.1 The Councils' in-house treasury management team provide services to Mid Sussex DC under a Shared Services Arrangement (SSA). The initial three year term for this arrangement expired on 17th October 2013, and has been renewed on similar terms for a further three years to 17th October 2016.

Worthing Leisure Trust

6.2 The arrangements for establishing The Worthing Leisure Trust include provision for Worthing Council to provide the Trust with temporary cash flow advances (if required) up to a maximum of £500k to assist it in the early start-up years. Such advances as may be made shall be repayable as soon as practical and attract a rate of interest for the loan term of Bank Base Rate plus 5%.

Close Brothers Limited

6.3 To offer more options for diversification, the UK bank Close Brothers Limited has been added to the list of specified investments, to be approved with this report.

7.0 LEGAL

7.1 Part 1 of the Local Government Act 2003 provides a legal framework of powers for and duties upon Local Authorities in relation to the borrowing of money and capital finance.

7.2 The Local Authorities (Capital Finance and Accounting) (England) Regulation 2003 provide additional legislative guidance, including, the duty to have regard to the code of practice entitled the "Prudential Code for Capital Finance in Local Authorities" published by CIPFA, as amended or reissued from time to time.

8.0 RECOMMENDATIONS

8.1 The Joint Strategic Committee is recommended to:

i) approve and adopt the TMSS and AIS for 2016/17-2018/19, incorporating the Prudential Indicators and Limits, and MRP Statements

ii) forward the Prudential Indicators and Limits, and MRP Statements of the report for approval by Worthing Council at its meeting on 23 February 2016, and by Adur Council at its meeting on 25 February 2016.

iii) Forward the report for noting to the meeting of the Joint Governance Committee to be held on 22 March 2016.

8.0 RECOMMENDATIONS

8.2 The Joint Governance Committee is recommended to:

i) note the TMSS and AIS report (including the Prudential Indicators and Limits, and MRP Statements) for 2016/17 - 2018/19,

ii) refer any comments on or amendment to the TMSS and AIS to the next meeting of the Joint Strategic Committee.

Principal Author and Contact Officer:
Pamela Coppelman, Group Accountant (Strategic Finance)
Direct Dialling No: (01903) 221236
Email: pamela.coppelman@adur-worthing.gov.uk

Background Papers:

(1) Joint Treasury Management Strategy and Annual Investment Strategy 2015/16 to 2017/18, JSC 5 Feb 2015.

(2) Overall Budget Estimates 2016/17 and Setting of 2016/17 Council Tax Report

(3) TMSS and AIS Template Report – Capita Treasury Solutions Limited.

(4) Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA 2011).

(5) CLG Investment Guidance (Revised April 2010).

(6) The Prudential Code for Capital Finance in Local Authorities (CIPFA 2013)

SCHEDULE OF OTHER MATTERS

1.0 COUNCIL PRIORITY

1.1 Matters considered and no issues identified.

2.0 SPECIFIC ACTION PLANS

2.1 Those matters considered and contained within the TMSS and AIS reported here-in.

3.0 SUSTAINABILITY ISSUES

3.1 Matter considered and no issues identified

4.0 EQUALITY ISSUES

4.1 Matter considered and no issues identified

5.0 COMMUNITY SAFETY ISSUES (SECTION 17)

5.1 Matter considered and no issues identified

6.0 HUMAN RIGHTS ISSUES

6.1 Matter considered and no issues identified

7.0 REPUTATION

7.1 Matter considered and no issues identified

8.0 CONSULTATIONS

8.1 Matters considered in conjunction with the Councils' Treasury Management consultants.

9.0 RISK ASSESSMENT

9.1 Matter considered within Para 1.3 of the report.

10.0 HEALTH AND SAFETY ISSUES

10.1 Matter considered and no issues identified

11.0 PROCUREMENT STRATEGY

11.1 Matter considered and no issues identified

12.0 PARTNERSHIP WORKING

12.1 Matter considered and no issues identified

SPECIFIED AND NON SPECIFIED INVESTMENTS

SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments identified for use by the Councils
Specified Investments will be those that meet the criteria in the CLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year
- meets the "high" credit criteria as determined by the Councils or is made with the UK government or is made with a local authority in England, Wales and Scotland.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

"Specified" Investments identified for the Councils' use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV)
- Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

** Investments in these instruments will be on advice from the Councils' treasury advisor.*

For credit rated counterparties, the minimum criteria, excepting for the Councils' own banker and the specified building societies, (see below) will be the short-term / long-term ratings assigned by various agencies which may include Moody's Investors Services, Standard and Poor's, Fitch Ratings, being:

Long-term investments (365 days or more) : minimum: Aa3 (Moody's) or A- (SandP) or A- (Fitch)
Or
Short-term investments (364 days or less) : minimum P-1 (Moody's) or A-1 (SandP) or F1 (Fitch).

For all investments the Councils will also take into account information on corporate developments of, and market sentiment towards, investment counterparties.

ADUR DISTRICT COUNCIL
SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments identified for use by the Council
New specified investments will be made within the following limits:

Instrument	Country and Sovereign Rating	Counterparty	Maximum Exposure Limit £m
Term Deposits	UK – AA+	DMADF, DMO	No limit
Term Deposits/Call Accounts	UK – AA+	Other UK Local Authorities	No limit
Term Deposits/Call Accounts	UK – AA+	Santander (UK)	£4m
Term Deposits/Call Accounts	UK – AA+	Bank of Scotland/Lloyds	£4m
Term Deposits/Call Accounts	UK – AA+	Barclays	£4m
Term Deposits/Call Accounts	UK – AA+	Clydesdale	£4m
Term Deposits/Call Accounts	Sweden – AAA	Svenska Handelsbanken AB	£3m
Term Deposits/Call Accounts	UK – AA+	HSBC	£4m
Term Deposits/Call Accounts	UK – AA+	Royal Bank of Scotland	£4m
Term Deposits /Call / Overnight Accounts	UK – AA+	Close Brothers Limited	£4m
Term Deposits/Call Accounts	Germany – AAA	Deutsche Bank AG	£3m
Term Deposits/Call Accounts	Australia – AAA	National Australia Bank	£3m
Term Deposits/Call Accounts	US – AA+	JP Morgan	£3m
Term Deposits/Call Accounts	UK – AA+	Goldman Sachs International Bank	£3m
Gilts	UK – AA+	Debt Management office (DMO)	£3m or 25% of funds
Bonds	EU	European Investment Bank/Council of Europe	£3m or 25% of funds
AAA Rated Money Market Funds	UK/Ireland incorporated	Constant Net Asset Value MMFs	£5m or 30% of funds
Other MMFs and CIS	UK – AAA	Collective Investment Schemes	25%

ADUR DISTRICT COUNCIL
SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments identified for use by the Council
New specified investments will be made within the following limits:

Instrument	Country and Sovereign Rating	Counterparty	Maximum Exposure Limit £m
Term Deposits	UK – AA+	Nationwide BS	£4m
Term Deposits	UK – AA+	Yorkshire BS	£2m
Term Deposits	UK – AA+	Coventry BS	£2m
Term Deposits	UK – AA+	Skipton BS	£2m
Term Deposits	UK – AA+	Leeds BS	£2m
Share Capital	n/a	Local Capital Finance Company.	£0.05m
Share Capital/Loans	n/a	West Sussex Credit Union	£0.025k Share Capital

NB Any existing deposits outside of the current criteria will be reinvested with the above criteria on maturity.

NB No more than 25% of funds shall be invested in Non-UK financial institutions whether by term deposits, call accounts or Money Market Funds, or any combination thereof.

NB Investments in AAA rated Money Market Funds are limited to £5m or 30% of funds except that this limit may be breached for liquidity purposes for up to 1 week at any time.

ADUR DISTRICT COUNCIL
NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL:

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use.

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
• Deposits with banks and building societies • Certificates of deposit with banks and building societies	√ √	 √	5 years	The higher of £8m or 50% of funds	No
Gilts and Bonds: • Gilts • Bonds issued by multilateral development banks • Bonds issued by financial institutions guaranteed by the UK government • Sterling denominated bonds by non-UK sovereign governments	√ √ √ √ (on advice from treasury advisor)	√ √ √ √	5 years	The higher of £3m or 25% of funds	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No. 534 and SI 2007, No. 573), but which are not credit rated.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date.	The higher of £5m or 30% of funds	No
Government guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Yes

SPECIFIED AND NON SPECIFIED INVESTMENTS

ADUR DISTRICT COUNCIL
NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL:

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
Non-guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Yes
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No. 534 or SI 2007, No. 573.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	The higher of £2m or 20% of funds	Yes

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

2. The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

WORTHING BOROUGH COUNCIL
SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments identified for use by the Council
New specified investments will be made within the following limits:

Instrument	Country and Sovereign Rating	Counterparty	Maximum Exposure Limit £m
Term Deposits	UK – AA+	DMADF, DMO	No limit
Term Deposits/Call Accounts	UK – AA+	Other UK Local Authorities	No limit
Term Deposits/Call Accounts	UK – AA+	Santander UK	£4m
Term Deposits/Call Accounts	UK – AA+	Bank of Scotland/Lloyds	£4m
Term Deposits/Call Accounts	UK – AA+	Barclays	£4m
Term Deposits/Call Accounts	UK – AA+	Clydesdale	£4m
Term Deposits/Call Accounts	UK – AA+	HSBC	£4m
Term Deposits /Call / Overnight Accounts	UK – AA+	Close Brothers Limited	£4m
Term Deposits/Call Accounts	UK – AA+	Royal Bank of Scotland	£4m
Term Deposits/Call Accounts	Australia – AAA	National Australia Bank Limited	£3m
Term Deposits/Call Accounts	Germany - AAA	Deutsche Bank AG	£3m
Term Deposits/Call Accounts	Sweden – AAA	Svenska Handelsbanken AB	£3m
Term Deposits/Call Accounts	US – AA+	JP Morgan	£3m
Term Deposits/Call Accounts	UK – AA+	Goldman Sachs International Bank	£3m
Gilts	UK – AA+	Debt Management Office (DMO)	£3m or 25% of funds
Bonds	EU	European Investment Bank/Council of Europe	£3m or 25% of funds
AAA Rated Money Market Funds	UK/Ireland incorporated	Constant Net Asset Value MMFs	£5m or 30% of funds
Other MMFs and CIS	UK – AA+	Collective Investment Schemes	25%
Term Deposits	UK – AA+	Nationwide BS	£4m

WORTHING BOROUGH COUNCIL
SPECIFIED AND NON SPECIFIED INVESTMENTS

Instrument	Country and Sovereign Rating	Counterparty	Maximum Exposure Limit £m
Term Deposits	UK – AA+	Yorkshire BS	£2m
Term Deposits	UK – AA+	Coventry BS	£2m
Term Deposits	UK – AA+	Skipton BS	£2m
Term Deposits	UK – AA+	Leeds BS	£2m
Share Capital	n/a	Local Capital Finance Company.	£0.05m
Share Capital	n/a	West Sussex Credit Union	£0.025m Share Capital
Term Deposits	n/a	Worthing Homes Limited	£10m
Temporary Loans	n/a	Worthing Leisure Trust	£0.5m

NB Any existing deposits outside of the current criteria will be reinvested with the above criteria on maturity.

NB No more than 25% of funds shall be invested in Non-UK financial institutions whether by term deposits, call accounts or Money Market Funds, or any combination thereof.

NB Investments in AAA rated Money Market Funds are limited to £5m or 30% of funds except that this limit may be breached for liquidity purposes for up to 1 week at any time.

SPECIFIED AND NON SPECIFIED INVESTMENTS

WORTHING BOROUGH COUNCIL
NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL:

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use.

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
• Deposits with banks and building societies • Certificates of deposit with banks and building societies*	√ √	 √	5 years	The higher of £10m or 50% of funds	No
Gilts and Bonds*: • Gilts • Bonds issued by multilateral development banks • Bonds issued by financial institutions guaranteed by the UK government • Sterling denominated bonds by non-UK sovereign governments	√ √ √ √ (on advice from treasury advisor)	√ √ √ √	5 years	The higher of £3m or 25% of funds	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No. 534 and SI 2007, No. 573), but which are not credit rated.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date.	The higher of £5m or 30% of funds	No
Government guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £5m or 20% of funds	Yes

SPECIFIED AND NON SPECIFIED INVESTMENTS

WORTHING BOROUGH COUNCIL
NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL:

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
Non-guaranteed bonds and debt instruments (e.g. floating rate notes issued by Corporate Bodies)	√ (on advice from treasury advisor	√	5 years	The higher of £2m or 10% of funds	Yes
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No. 534 or SI 2007, No. 573.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	The higher of £2m or 20% of funds	Yes

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

2. The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

APPENDIX B

TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) **Full Council**

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual Treasury Management Strategy Statement and Annual Investment Strategy
- approval of MRP Statement

(ii) **Joint Strategic Committee**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

(iii) **Joint Governance Committee**

Receiving and reviewing the following, and making recommendations to the Cabinet

- regular monitoring reports on compliance with the Treasury Management Strategy, practices and procedures.

(iv) **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.

CAPITA ASSET SERVICES COMMENTARY ON THE GLOBAL ECONOMY

Economic Background

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.%.

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. 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.

There is, therefore, considerable uncertainty around how quickly 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, , 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 'noflation' 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 ncreases after that be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers 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.

APPENDIX C

CAPITA ASSET SERVICES COMMENTARY ON THE GLOBAL ECONOMY

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 strongly in Q2 to 3.9% (annualised) before 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 Fed. start to increase rates in September. he Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the initial resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

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.% after a short burst of strong growth of 1.% during Q1the fourth in five years. has been hit hard by the downturn in China during 2015 the Abe government has already firedfirst two arrowsbut has dithered 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. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of 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 the EU would be envious of. 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 considerable concerns about the vulnerability of some emerging countries and their corporates which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries) there is now a strong flow back to those western economies with strong growth and an imminent rise in interest rates and bond yields.

CAPITA ASSET SERVICES COMMENTARY ON THE GLOBAL ECONOMY

This change in investors' strategy, and the massive 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

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 the start of Fed rate increases, causing a flight to safe havens

APPENDIX C

CAPITA ASSET SERVICES COMMENTARY ON THE GLOBAL ECONOMY

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

Uncertainty around the risk of a UK exit from the EU

The commencement by the US Federal Reserve of increases in the Fed. Funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities

UK inflation returning to significantly higher levels than in the wider EU and US causing an increase in the inflation premium inherent to gilt yields