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# Crawley Borough Council

## Report to Overview & Scrutiny Commission
**8 February 2016**

## Report to Cabinet
**10 February 2016**

## Treasury Management Strategy 2016/2017

Report of the Head of Finance, Revenues and Benefits, **FIN/381**

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## 1. Purpose

1.1 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 Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

1.2 In respect of non-Housing Revenue Account activities, the Council's policy is to remain debt free and invest according to the principles of security, liquidity and yield.

1.3 There are no material changes to the investment strategy in section 7 and appendix 3 compared with the 2015/2016 strategy.

## 2. Recommendations

2.1 To the Overview and Scrutiny Commission:

That the Commission considers the report and decides what comments, if any, it wishes to submit to the Cabinet.

2.2 To the Cabinet

The Cabinet is requested to recommend to Council the approval of:-

a) the Treasury Prudential Indicators and the Minimum Revenue Provision (MRP) Statement contained within Section 5;
b) the Treasury Management Strategy contained within Section 6;
c) the Investment Strategy contained within Section 7, and the detailed criteria included in Appendix 3;

## 3. Reasons for the Recommendations

3.1 The Council's financial regulations, in accordance with the CIPFA Code of Practice for Treasury Management, requires a Treasury Management Strategy to be approved for the forthcoming financial year. This report complies with these requirements.

## 4. Background

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

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

4.3 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."*

## 5. The Capital Prudential Indicators 2016/17 – 2018/19

### 5.1 The Capital Expenditure Plans

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

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

| Capital Expenditure £'000 | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| Cabinet | 426 | 1,113 | 7,324 | 85 | 0 |
| Resources | 581 | 429 | 387 | 60 | 0 |
| Environment Services & Sustainability | 6,844 | 2,350 | 3,742 | 1,247 | 0 |
| Planning & Economic Development | 10,990 | 0 | 8,792 | 200 | 0 |
| Public Protection & Community Engagement | 104 | 79 | 100 | 70 | 0 |
| Housing Services | 924 | 2,534 | 914 | 822 | 1,891 |
| Wellbeing | 2,454 | 3,980 | 2,492 | 838 | 1,211 |
| **General Fund** | **22,323** | **10,485** | **23,751** | **3,322** | **3,102** |
| **HRA** | **15,979** | **24,531** | **35,837** | **39,923** | **18,952** |
| **Total** | **38,302** | **35,016** | **59,588** | **43,245** | **22,054** |

5.1.3 The table below summarises the above 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.

| Capital Expenditure £'000 | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| General Fund | 22,323 | 10,485 | 23,751 | 3,322 | 3,102 |
| HRA | 15,979 | 24,531 | 35,837 | 39,923 | 18,952 |
| Total | 38,302 | 35,016 | 59,588 | 43,245 | 22,054 |
| **Financed by:** | | | | | |
| Capital receipts | 13,426 | 6,208 | 12,292 | 2,816 | 3,102 |
| Capital reserves | 0 | 0 | 8,792 | 0 | 0 |
| 1-4-1 receipts | 374 | 3,424 | 5,836 | 6,964 | 1,355 |
| Replacement funds | 7,505 | 468 | 163 | 60 | 0 |
| Capital grants | 3,044 | 1,896 | 2,504 | 446 | 0 |
| Major Repairs Reserve | 13,953 | 23,020 | 30,001 | 32,959 | 17,597 |
| **Net financing need for the year** | **0** | **0** | **0** | **0** | **0** |

### 5.2 The Council's borrowing need (the Capital Financing Requirement).

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

5.2.2 The Council is asked to approve the CFR projections below:

| £'000 | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **Capital Financing Requirement** | | | | | |
| CFR – General Fund | (207) | (207) | (207) | (207) | (207) |
| CFR - HRA | 260,147 | 260,147 | 260,147 | 260,147 | 260,147 |
| **Total CFR** | **259,940** | **259,940** | **259,940** | **259,940** | **259,940** |
| **Movement in CFR** | **(55)** | **0** | **0** | **0** | **0** |

| **Movement in CFR represented by** | | | | | |
|---|---|---|---|---|---|
| Net financing need for the year (above) | 0 | 0 | 0 | 0 | 0 |
| Less MRP/VRP and other financing movements | (55) | 0 | 0 | 0 | 0 |
| **Movement in CFR** | **(55)** | **0** | **0** | **0** | **0** |

5.2.3 The large CFR on the HRA is due to the self-financing settlement in 2011/12.

## 5.3 Minimum revenue provision (MRP) policy statement

5.3.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

5.3.2 Government regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

5.3.3 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outlined in former CLG regulations (option 1)

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

5.3.4 From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3)

This option provides for a reduction in the borrowing need over approximately the asset's life.

5.3.5 There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

**5.4 Core funds and expected investment balances**

5.4.1 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

| **Year End Resources £'000** | **2014/15 Actual** | **2015/16 Estimate** | **2016/17 Estimate** | **2017/18 Estimate** | **2018/19 Estimate** |
|---|---|---|---|---|---|
| Fund balances / reserves | 52,880 | 50,106 | 45,752 | 32,466 | 32,522 |
| Capital receipts* | 37,516 | 34,282 | 22,554 | 19,174 | 21,117 |
| **Total core funds** | **90,396** | **84,388** | **68,306** | **51,640** | **53,639** |
| Working capital* | 21,575 | 29,658 | 28,000 | 28,000 | 26,000 |
| Under/over borrowing | 385 | 385 | 385 | 385 | 385 |
| **Expected investments** | **112,356** | **114,431** | **96,691** | **80,025** | **80,024** |

* includes 1-4-1 receipts

**5.5 Affordability prudential indicators**

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

5.5.2 **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.

| **%** | **2016/17 Estimate** | **2017/18 Estimate** | **2018/19 Estimate** |
|---|---|---|---|
| General Fund | -7.50% | -9.92% | -13.75% |
| HRA | 17.39% | 17.78% | 17.66% |

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

5.5.3 **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 Council's 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.

| £ | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate |
|---|---|---|---|
| **Council tax - band D** | nil | nil | nil |

5.5.4 **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 Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

| £ | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|
| **Weekly housing rent levels** | nil | nil | nil |

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

5.5.5 **HRA ratios**

| | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **HRA debt £'000** | 260,325 | 260,325 | 260,325 | 260,325 | 260,325 |
| **HRA revenues £'000** | 47,554 | 47,339 | 47,219 | 46,427 | 46,938 |
| **Ratio of debt to revenues %** | 547 | 550 | 550 | 561 | 555 |

| | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **HRA debt £'000** | 260,325 | 260,325 | 260,325 | 260,325 | 260,325 |
| **Number of HRA dwellings** | 7,904 | 7,864 | 7,849 | 7,998 | 8,049 |
| **Debt per dwelling £** | 32,936 | 33,103 | 33,167 | 32,549 | 32,343 |

## 6. Borrowing

6.1 The capital expenditure plans set out in Section 5 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

### 6.2 Current portfolio position

6.2.1 The Council's treasury portfolio position 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.

| £'000 | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **External Debt** | | | | | |
| Debt at 1 April | 260,325 | 260,325 | 260,325 | 260,325 | 260,325 |
| Expected change in Debt | 0 | 0 | 0 | 0 | 0 |
| Other long-term liabilities (OLTL) | 0 | 0 | 0 | 0 | 0 |
| Expected change in OLTL | 0 | 0 | 0 | 0 | 0 |
| **Actual debt at 31 March (A)** | **260,325** | **260,325** | **260,325** | **260,325** | **260,325** |
| The Capital Financing Requirement | 259,940 | 259,940 | 259,940 | 259,940 | 259,940 |
| Under / (over) borrowing | (385) | (385) | (385) | (385) | (385) |

6.2.2 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross 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.

6.2.3 The Head of Finance, Revenues and Benefits reports that the Council 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.

### 6.3 Treasury Indicators: Limits to Borrowing Activity

6.3.1 **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.

| Operational boundary £'000 | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|
| Debt | 260,325 | 260,325 | 260,325 | 260,325 |
| Other long term liabilities | 0 | 0 | 0 | 0 |
| Total | 260,325 | 260,325 | 260,325 | 260,325 |

6.3.2 **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 Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

6.3.3 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.

6.3.4 The Council is asked to approve the following Authorised Limit:

| Authorised limit £'000 | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|
| Debt | 270,325 | 270,325 | 270,325 | 270,325 |
| Other long term liabilities | 0 | 0 | 0 | 0 |
| Total | 270,325 | 270,325 | 270,325 | 270,325 |

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

| HRA Debt Limit £'000 | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|
| HRA debt cap | 263,902 | 263,902 | 263,902 | 263,902 |
| HRA CFR | 260,325 | 260,325 | 260,325 | 260,325 |
| HRA headroom | 3,577 | 3,577 | 3,577 | 3,577 |

## 6.4 Prospects for Interest Rates

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

| | Mar-16 | Jun-16 | Sep-16 | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 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% |

6.4.2 Investment returns are likely to remain relatively low during 2016/17 and beyond.

6.4.3 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.

### 6.5 Borrowing Strategy

6.5.1 The Council borrowed £260.325m in 2011/12 for the HRA self-financing settlement. The General Fund remains debt free, and this position is not expected to change during 2016/17.

6.5.2 **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 Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

| **£'000** | **2016/17** | **2017/18** | **2018/19** |
|---|---|---|---|
| **Interest rate Exposures** | | | |
| | **Upper** | **Upper** | **Upper** |
| **Limits on fixed interest rates:**<br>• **Debt only**<br>• **Investments only** | <br>270,325<br>140,000 | <br>270,325<br>140,000 | <br>270,325<br>140,000 |
| **Limits on variable interest rates**<br>• **Debt only**<br>• **Investments only** | <br>10,000<br>40,000 | <br>10,000<br>40,000 | <br>10,000<br>40,000 |
| **Maturity Structure of fixed interest rate borrowing 2015/16** | | | |
| | | **Lower** | **Upper** |
| Under 12 months | | 0% | 10% |
| 12 months to 2 years | | 0% | 10% |
| 2 years to 5 years | | 0% | 10% |
| 5 years to 10 years | | 0% | 20% |
| 10 years to 20 years | | 0% | 80% |
| 20 years to 30 years | | 0% | 25% |
| 30 years to 40 years | | 0% | 10% |
| 40 years to 50 years | | 0% | 10% |

### 6.6 Policy on borrowing in advance of need

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

6.6.2 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.

### 6.7 Debt rescheduling

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

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

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

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

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

## 7. Annual Investment Strategy

### 7.1 Investment Policy

7.1.1 The Council’s investment policy has regard to the Government’s Guidance on Local Government Investments (“the Guidance”) and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”). The Council’s investment priorities will be security first, liquidity second and then return.

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

7.1.3 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the

Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

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

7.1.5 Investment instruments identified for use in the financial year are listed in Appendix 3 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices – schedules.

## 7.2 Creditworthiness policy

7.2.1 This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody’s and Standard and Poor’s. The credit ratings of counterparties are supplemented with the following overlays:

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

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

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

| Y | Pi1 | Pi2 | P | B | O | R | G | N/C |
|---|---|---|---|---|---|---|---|---|
| 1 | 1.25 | 1.5 | 2 | 3 | 4 | 5 | 6 | 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 |

| | Colour (and long term rating where applicable) | Money Limit | Time Limit |
|---|---|---|---|
| Banks * | yellow | unlimited | 5 yrs |
| Banks | purple | £15m | 2 yrs |
| Banks – part nationalised | blue | £15m | 1 yr |
| Banks | orange | £10m | 1 yr |
| Banks | red | £10m | 6 mths |
| Banks | green | £10m | 100 days |
| Banks | No colour | Not to be used | |
| Limit 3 category – Council's banker (not meeting Banks 1) | n/a | £1m | 1 day |
| Corporate Bonds | AA-<br>A- | £5m<br>£2m | 2 yrs<br>1 yr |
| DMADF | AAA | unlimited | 6 months |
| Local authorities | n/a | £15m | 5 yrs |
| Money market funds | AAA | £15m | liquid |
| Enhanced money market funds with a credit score of 1.25 | Dark pink / AAA | £10m | liquid |
| Enhanced money market funds with a credit score of 1.5 | Light pink / AAA | £10m | liquid |

** Please note: the yellow colour category is for UK Government debt, or its equivalent, constant NAV money market funds and collateralised deposits where the collateral is UK Government debt.*

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

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

7.2.5 All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of Capita's creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme

market movements may result in downgrade of an institution or removal from the Council's lending list.

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

**7.3 Ethical Investment Policy**

7.3.1 The Council will not undertake direct investment or borrowing activities with organisations whose core activities include:

- Armaments – weapon systems
- Gambling
- Pornography
- Tobacco
- Pay-day loans

7.3.2 In order to comply with treasury management guidance, the Council's investments will prioritise security, liquidity and yield in that order. The Ethical Investment Policy thereby becomes a fourth consideration in the decision making process.

7.3.3 The core activities in the Ethical Investment Policy above has been chosen after careful consideration of the Policy direction of the administration, the officer time in implementing the policy, the cost of external resources, and the timeliness of investment decisions.

**7.4 Country limits**

7.4.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 4. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

**7.5 Investment strategy**

7.5.1 **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).

7.5.2 **Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2016. Bank Rate forecasts for financial year ends (March) are:

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

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

| | |
|---|---|
| 2016/17 | 0.60% |
| 2017/18 | 1.25% |
| 2018/19 | 1.75% |
| 2019/20 | 2.25% |
| 2020/21 | 2.50% |
| 2021/22 | 2.75% |
| 2022/23 | 2.75% |
| 2023/24 | 3.00% |
| Later years | 3.00% |

7.5.4 The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk.

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

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

| **Maximum principal sums invested > 364 days** | | | |
|---|---|---|---|
| **£m** | **2016/17** | **2017/18** | **2018/19** |
| Principal sums invested > 364 days | £50m | £50m | £50m |

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

7.5.7 Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- **0.15% historic risk of default when compared to the whole portfolio.**

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

- Bank overdraft - £0.1m
- Liquid short term deposits of at least £2m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.7 years, with a maximum of 1.20 years.

7.5.9 Yield - local measures of yield benchmarks are:

- Investments – internal returns 0.2% above the 7 day LIBID rate

7.5.10 And in addition that the security benchmark for each individual year is:

| | 1 year | 2 years | 3 years | 4 years | 5 years |
|---|---|---|---|---|---|
| **Maximum** | **0.03%** | **0.22%** | **0.40%** | **0.56%** | **0.74%** |

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

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

**7.6 Treasury management consultants**

7.6.1 The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

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

7.6.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

## 8. Implications

8.1 There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the public services, the Local Government Investment Guidance provides that the council's investments are and will continue to be, within its legal powers.

## 9. Background Papers

Treasury Management Strategy for 2015/2016 – Cabinet, 11 February 2015 [report FIN/355 refers].
2016/2017 Budget and Council Tax – Cabinet, 10 February 2016 [report FIN/380 refers].
"Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes", 2011 Edition – Chartered Institute of Public Finance and Accountancy.
"The Prudential Code for Capital Finance in Local Authorities", 2011 Edition – Chartered Institute of Public Finance and Accountancy.

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## Appendix 1: Interest Rate Forecasts 2016 – 2019

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

| Capita Asset Services Interest Rate View | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec-15 | Mar-16 | Jun-16 | Sep-16 | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 |
| Bank Rate View | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% | 1.50% | 1.50% | 1.75% | 1.75% | 2.00% | 2.00% | 2.00% |
| 3 Month LIBID | 0.60% | 0.70% | 0.80% | 0.90% | 1.10% | 1.30% | 1.40% | 1.50% | 1.80% | 1.90% | 1.90% | 2.00% | 2.00% | 2.10% |
| 6 Month LIBID | 0.80% | 0.90% | 1.00% | 1.10% | 1.30% | 1.50% | 1.60% | 1.70% | 2.00% | 2.10% | 2.10% | 2.20% | 2.20% | 2.30% |
| 12 Month LIBID | 1.10% | 1.20% | 1.30% | 1.40% | 1.60% | 1.80% | 1.90% | 2.00% | 2.30% | 2.40% | 2.40% | 2.50% | 2.50% | 2.70% |
| 5yr PWLB Rate | 2.30% | 2.40% | 2.60% | 2.70% | 2.80% | 2.80% | 2.90% | 3.00% | 3.20% | 3.30% | 3.40% | 3.50% | 3.50% | 3.60% |
| 10yr PWLB Rate | 2.90% | 3.00% | 3.10% | 3.20% | 3.30% | 3.40% | 3.50% | 3.60% | 3.70% | 3.80% | 3.90% | 4.00% | 4.10% | 4.10% |
| 25yr PWLB Rate | 3.60% | 3.70% | 3.80% | 3.90% | 4.00% | 4.10% | 4.10% | 4.20% | 4.30% | 4.30% | 4.40% | 4.40% | 4.40% | 4.50% |
| 50yr PWLB Rate | 3.50% | 3.60% | 3.70% | 3.80% | 3.90% | 4.00% | 4.00% | 4.10% | 4.20% | 4.20% | 4.30% | 4.30% | 4.30% | 4.40% |
| **Bank Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% | 1.50% | 1.50% | 1.75% | 1.75% | 2.00% | 2.00% | 2.00% |
| Capital Economics | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% | 1.25% | 1.50% | - | - | - | - | - |
| **5yr PWLB Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 2.30% | 2.40% | 2.60% | 2.70% | 2.80% | 2.80% | 2.90% | 3.00% | 3.20% | 3.30% | 3.40% | 3.50% | 3.50% | 3.60% |
| Capital Economics | 2.40% | 2.60% | 2.70% | 2.80% | 3.00% | 3.10% | 3.20% | 3.30% | 3.50% | - | - | - | - | - |
| **10yr PWLB Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 2.90% | 3.00% | 3.10% | 3.20% | 3.30% | 3.40% | 3.50% | 3.60% | 3.70% | 3.80% | 3.90% | 4.00% | 4.10% | 4.10% |
| Capital Economics | 3.35% | 3.35% | 3.45% | 3.45% | 3.55% | 3.65% | 3.75% | 3.85% | 3.95% | - | - | - | - | - |
| **25yr PWLB Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 3.60% | 3.70% | 3.80% | 3.90% | 4.00% | 4.10% | 4.10% | 4.20% | 4.30% | 4.30% | 4.40% | 4.40% | 4.40% | 4.50% |
| Capital Economics | 3.35% | 3.35% | 3.45% | 3.45% | 3.55% | 3.65% | 3.75% | 3.85% | 3.95% | - | - | - | - | - |
| **50yr PWLB Rate** | | | | | | | | | | | | | | |
| Capita Asset Services | 3.50% | 3.60% | 3.70% | 3.80% | 3.90% | 4.00% | 4.00% | 4.10% | 4.20% | 4.20% | 4.30% | 4.30% | 4.30% | 4.40% |
| Capital Economics | 3.40% | 3.40% | 3.50% | 3.50% | 3.60% | 3.70% | 3.80% | 3.90% | 4.00% | - | - | - | - | - |

## APPENDIX 2: 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 although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 2015 was weak at +0.4% (+2.9% y/y), although there was a slight increase in quarter 2 to +0.5% before weakening again to +0.4% (+2.1% 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 5.1%.

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

- *Quarter-on-quarter GDP growth is above 0.6% i.e. using up spare capacity. This condition was met in Q2 2015, but Q3 came up short and Q4 looks likely to also fall short.*
- *Core inflation (stripping out most of the effect of decreases in oil prices), registers a concerted increase towards the MPC's 2% target. This measure was on a steadily decreasing trend since mid-2014 until November 2015 @ 1.2%. December 2015 saw a slight increase to 1.4%.*
- *Unit wage costs are on a significant increasing trend. This would imply that spare capacity for increases in employment and productivity gains are being exhausted, and that further economic growth will fuel inflationary pressures.*

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. However, it is unlikely that the MPC would start raising rates until wage inflation was expected to consistently stay over 3%, as a labour productivity growth rate of around 2% would mean that net labour unit costs would still only be rising by about 1% y/y. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. However, the first round of falls in oil, gas and food prices in late 2014 and in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but only to be followed by a second, subsequent round of falls in fuel and commodity prices which will delay a significant tick up in inflation from around zero. CPI inflation is now expected to get back to around 1% in the second half of 2016 and not get near to 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase.

However, with the price of oil having fallen further in January 2016, and with sanctions having been lifted on Iran, enabling it to sell oil freely into international markets, there could well be some further falls still to come in 2016. The price of other commodities exported by emerging countries could also have downside risk and several have seen their currencies already fall by 20-30%, (or more), over the last year. These developments could well lead the Bank of England to lower the pace of increases in inflation in its February 2016 Inflation

Report. On the other hand, the start of the national living wage in April 2016 (and further staged increases until 2020), will raise wage inflation; however, it could also result in a decrease in employment so the overall inflationary impact may be muted.

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

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

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively over the last year from Q4 2015 to Q4 2016. Increases after that are also likely to be at a much slower pace, and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008. There has also been an increase in momentum towards holding a referendum on membership of the EU in 2016, rather than in 2017, with Q3 2016 being the current front runner in terms of timing; this could impact on MPC considerations to hold off from a first increase until the uncertainty caused by it has passed.

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

**USA**GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded remarkably strongly in Q2 to 3.9% (annualised) before falling back to +2.0% 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. would start to increase rates in September. The Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong while November was also reasonably strong (and December was outstanding); this, therefore, opened up the way for the Fed. to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

**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. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

**Greece**. During July, Greece finally 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.

**Portugal and Spain.** The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. A left wing / communist anti-austerity coalition has won a majority of seats in Portugal. The general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

**China and Japan.** Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Abe government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its 'arrows' of reform but has 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 and the start of 2016, in implementing several stimulus measures to try to ensure the economy hits the growth target of about 7% for 2015. It has also sought to bring some stability after the major fall in the onshore Chinese stock market during the summer and then a second bout in January 2016. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, there are growing concerns about whether the Chinese economy could be heading for a hard landing and weak progress in rebalancing the economy from an over dependency on manufacturing and investment to consumer demand led services. There are also concerns over the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September and again in January 2016, which could lead to a flight to quality to bond markets. In addition, the international value of the Chinese currency has been on a steady trend of weakening and this will put further downward pressure on the currencies of emerging countries dependent for earnings on exports of their commodities.

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

The currencies of emerging countries have therefore been depressed by both this change in investors' strategy, and the consequent massive reverse cash flow, and also by the expectations of a series of central interest rate increases in the US which has caused the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed by a simultaneous downturn in demand for their exports and a deterioration in the value of their currencies. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

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

**CAPITA ASSET SERVICES FORWARD VIEW**

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

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

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

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

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

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

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

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

## APPENDIX 3: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

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

**NON-SPECIFIED INVESTMENTS**: These are any investments which do not meet the specified investment criteria. A maximum of 70% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

| Specified investments | Minimum credit criteria / colour band | £ limit per institution | Max. maturity period |
|---|---|---|---|
| DMADF – UK Government | N/A | unlimited | 6 months |
| UK Government gilts | UK sovereign rating | unlimited | 1 year |
| UK Government Treasury bills | UK sovereign rating | unlimited | 1 year |
| Bonds issued by multilateral development banks | UK sovereign rating | unlimited | 1 year |
| Money market funds | AAA | £15m | Liquid |
| Enhanced money market funds with a credit score of 1.25 | AAA | £10m | Liquid |
| Enhanced money market funds with a credit score of 1.5 | AAA | £10m | Liquid |
| Local authorities | N/A | £15m | 1 year |
| CDs or term deposits with banks and building societies | Yellow<br>Purple<br>Blue<br>Orange | £15m<br>£15m<br>£15m<br>£10m | 1 year |

| Non-specified investments | Minimum credit criteria / colour band | £ limit per institution | Max. maturity period |
|---|---|---|---|
| UK Government gilts | UK sovereign rating | unlimited | 5 years |
| Bonds issued by multilateral development banks | UK sovereign rating | unlimited | 5 years |
| Money market funds | AAA | £15m | Liquid |
| Enhanced money market funds with a credit score of 1.25 | AAA | £10m | Liquid |
| Enhanced money market funds with a credit score of 1.5 | AAA | £10m | Liquid |
| Local authorities | N/A | £15m | 5 years |
| CDs or Term deposits with banks and building societies | Yellow<br>Purple<br>Blue<br>Orange<br>Red<br>Green<br>No Colour | unlimited<br>£15m<br>£15m<br>£10m<br>£10m<br>£10m | Up to 5 years<br>Up to 2 years<br>Up to 1 year<br>Up to 1 year<br>Up to 6 Months<br>Up to 100 days<br>Not for use |
| Corporate bonds | AA-<br>A- | £5m<br>£2m | 1 year |

**APPENDIX 4: Approved countries for investments**

*This list is based on those countries which have sovereign ratings of AA- or higher and also have banks operating in sterling markets which have credit ratings of green or above in the Capita Asset Services credit worthiness service.*

AAA

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

AA+

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

AA

- Abu Dhabi (UAE)
- France
- Qatar

AA-

- Belgium