PAPER E

Purpose: For Noting

Committee report

Committee	**AUDIT COMMITTEE**
Date	**5 DECEMBER 2016**
Title	**TREASURY MANAGEMENT HALF-YEAR PROGRESS REPORT**
Report of	**TECHNICAL FINANCE MANAGER**

EXECUTIVE SUMMARY

1. In accordance with the Isle of Wight Council's Treasury Management Strategy 2016-17, this report presents the committee with a half-year progress report on treasury management policies, practices and activities for the financial year 2016-17.

2. This report is for noting.

BACKGROUND

3. The council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management ("the code"), which requires authorities to produce annually prudential indicators and a treasury management strategy statement on the likely financing and investment activity. The code also recommends that members are informed of treasury management activities at least twice a year.

4. This report, from a template provided by the council's treasury management advisers, Arlingclose Limited, sets out a summary of the council's treasury management activities in the half year to 30 September 2016, and it performance against the prudential indicators approved as part of the annual treasury management strategy. It also provides information about the broader economic background, against which the council's activities can be set.

STRATEGIC CONTEXT

5. The council's arrangements for treasury management support effective service and project delivery across the authority, in turn supporting the key priorities set out in the Corporate Plan 2015-17:

- Ensuring that all the resources available to the island are used in the most effective way in achieving the island's priorities

6. There is a need for regular review of the Treasury Management Strategy, in line with the Corporate Plan and Medium Term Financial Strategy, to ensure the key priorities of the council continue to be deliverable within the reduced resources available to the council.

FINANCIAL / BUDGET IMPLICATIONS

7. The council's current treasury management arrangements are conducted by council staff within existing budgets.

8. The treasury management strategy includes the overall management of the council's cash flow and borrowing strategy. With interest rates low, the strategy has been to avoid long-term external loans (with interest rates at in excess of 3%) and take short-term loans when needed (with interest rates of below 1%). This has generated significant savings as part of the budget strategies over recent years.

9. As a result of not undertaking as much short term borrowing as forecast in the Treasury Management Strategy 2016-17, the council anticipates a saving of approximately £450,000 in external interest costs for the year to 31 March 2017.

LEGAL IMPLICATIONS

10. Failure to provide this information will mean that the council is in breach of the requirements set out in the CIPFA Code of Practice for Treasury Management 2011, and the council's approved treasury management strategy 2016-17.

11. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 explicitly require English authorities to "have regard" to the code.

EQUALITY AND DIVERSITY

12. The council, as a public body, is required to meet its statutory obligations under the Equality Act 2010 to have due regard to eliminate unlawful discrimination, promote equal opportunities between people from different groups and to foster good relations between people who share a protected characteristic and people who do not share it.

13. Initial screening has indicated that there are no specific equality and diversity issues arising from the content of this report.

RISK MANAGEMENT

14. Treasury management activities have a high level of risk in that they relate to transactions that can amount to several million pounds which are undertaken with external bodies. When the council has surplus monies to invest, there are

risks if those organisations to whom it lends default on repayment. The costs to the council of its treasury management activities are dependent on fluctuating interest rates.

15. The overall strategy of borrowing short-term and avoiding long-term debt carries the risk that, if interest rates suddenly rise, when longer term debt is eventually required, it will cost more.

16. The council manages these risks by adopting a treasury management strategy which includes maintaining a limited list of organisations to whom it is authorised to lend, and restricting the maximum amount to be invested with each organisation, based on advice obtained from its external treasury management advisers, Arlingclose Limited. It also operates protocols for maintaining financial controls.

17. Although there is no statutory requirement to comply with the code, the council is obliged under section 151 of the Local Government Act 1972 to make arrangements for the proper administration of their financial affairs. Failure to comply with the code could result in adverse comments being raised by the council's external auditors.

18. The committee's overview of the council's treasury management arrangements plays an important part in the council's overall governance regime. It has an important role to play in the monitoring of treasury management activities, including overview of the risks faced by this function both internally, which are directly controllable through segregation of duties and reporting arrangements, and externally, controllable through the monitoring of counterparties and lending limits, and also regular monitoring of general economic factors.

RECOMMENDATION

19. That the committee receive this report and note the performance of the council's treasury management function for the first half of the year ended 31 March 2017.

APPENDICES ATTACHED

20. Appendix 1 – Semi-annual treasury report 2016-17

BACKGROUND PAPERS

21. Treasury Management Strategy 2016-17
https://www.iwight.com/Meetings/committees/mod-council/24-2-16/Appendix%20I.pdf

22. CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2011 Edition) http://www.tisonline.net/localauthorityaccounting/content/Treasury_Code_2011.pdf

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Half-Yearly Treasury Progress Report 2016/17

1. Introduction

The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that Authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end). This report provides an additional quarterly update.

The council's Treasury Management Strategy for 2016/17 was approved by Full Council on 24 February 2016, as part of the Medium-Term Budget Strategy Paper, which can be accessed on https://www.iwight.com/Meetings/committees/mod-council/24-2-16/Appendix%20I.pdf

The council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

2. External Context[1]

The preliminary estimate of Q2 2016 GDP showed reasonably strong growth as the economy grew 0.7% quarter-on-quarter, as compared to 0.4% in Q1 and year/year growth running at a healthy pace of 2.2%. However the UK economic outlook changed significantly on 23rd June 2016. The surprise result of the referendum on EU membership prompted forecasters to rip up previous projections and dust off worst-case scenarios. Growth forecasts had already been downgraded as 2016 progressed, as the very existence of the referendum dampened business investment, but the crystallisation of the risks and the subsequent political turmoil prompted a sharp decline in household, business and investor sentiment.

The repercussions of this plunge in sentiment on economic growth were judged by the Bank of England to be severe, prompting the Monetary Policy Committee to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy. The minutes of the August meeting also suggested that many members of the Committee supported a further cut in Bank Rate to near-zero levels (the Bank, however, does not appear keen to follow peers into negative rate territory) and more QE should the economic outlook worsen.

In response to the Bank of England's policy announcement, money market rates and bond yields declined to new record lows. Since the onset of the financial crisis over eight years ago, Arlingclose's rate outlook has progressed from 'lower for longer' to 'even lower for even longer' to, now, 'even lower for the indeterminable future'.

The new members of the UK government, particularly the Prime Minister and Chancellor, are likely to follow the example set by the Bank of England. After six years of fiscal consolidation, the Autumn Statement on 23 November is likely to witness fiscal initiatives to support economic activity and confidence, most likely infrastructure investment. Tax cuts or something similar cannot be ruled out.

Whilst the economic growth consequences of BREXIT remain speculative, there is uniformity in expectations that uncertainty over the UK's future trade relations with the EU and the rest of the

[1] Prepared by Arlingclose Limited at 30 September 2016

world will weigh on economic activity and business investment, dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment. These effects will dampen economic growth through the second half of 2016 and in 2017.

Meanwhile, inflation is expected to pick up due to a rise in import prices, dampening real wage growth and real investment returns. The August Quarterly *Inflation Report* from the Bank of England forecasts a rise in CPI to 0.9% by the end of calendar 2016 and thereafter a rise closer to the Bank's 2% target over the coming year, as previous rises in commodity prices and the sharp depreciation in sterling begin to drive up imported material costs for companies.

The rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes, concentrating instead on the negative effects of Brexit on economic activity and, ultimately, inflation.

Market reaction: Following the referendum result gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. The yield on the 10-year gilt fell from 1.37% on 23 June to a low of 0.52% in August, a quarter of what it was at the start of 2016. The 10-year gilt yield has since risen to 0.69% at the end of September. The yield on 2- and 3-year gilts briefly dipped into negative territory intra-day on 10th August to -0.1% as prices were driven higher by the Bank of England's bond repurchase programme. However both yields have since recovered to 0.07% and 0.08% respectively. The fall in gilt yields was reflected in the fall in PWLB borrowing rates, as evidenced in Table 2 in Appendix 2.

On the other hand, after an initial sharp drop, equity markets appeared to have shrugged off the result of the referendum and bounced back despite warnings from the IMF on the impact on growth from 'Brexit' as investors counted on QE-generated liquidity to drive risk assets.

The most noticeable fall in money market rates was for very short-dated periods (overnight to 1 month) where rates fell to between 0.1% and 0.2%

3. Local Context

At 31 March 2016 the council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £275.3 million, while usable reserves and working capital, which are the underlying resources available for investment, were £70.9 million.

At 31 March 2016 the council had £158.4 million of borrowing and £25.3 million of investments. The council's current strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing.

The council has an increasing CFR over the next 3 years due to the capital programme, but minimal investments and will therefore need to borrow up to £112 million over the forecast period.

4. Borrowing Strategy during the quarter

At 30 September 2016 the council held £161.4 million of loans, (a net increase of £3 million on the previous year end), as part of its strategy for funding previous years' capital programmes.

The council expects to borrow up to a further £30 million in 2016/17 and in doing so will not exceed the authorised limit for borrowing of £226 million.

Half-Yearly Treasury Progress Report 2016/17

The council's chief objective when borrowing continues to be striking an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the council's long-term plans change being a secondary objective.

Affordability and the "cost of carry" remained important influences on the council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

The fall in gilt yields and PWLB loan rates in the period leading up to and the large fall in yields following the EU referendum vote result provided an opportunity to borrow at/below the council's target borrowing rate(s). Post referendum, the fall in yields and PWLB rates was more pronounced as evidenced in Table 2 in Appendix 2.

In the first half of the financial year, the council funded £3 million of its capital expenditure from borrowing. In total £30 million of new fixed rate loans on an equal instalments of principal (EIP) basis, with an average rate of 2.2% and an average life of 25 years, were taken out to pay for future capital expenditure and to replace maturing loans. The Public Works Loans Board (PWLB) was the council's preferred source of borrowing given the transparency and control that its facilities continue to provide.

Borrowing Activity in 2016/17

	Balance on 01/04/2016 £m	Maturing Debt £m	Debt Prematurely Repaid £m	New Borrowing £m	Balance on 30/09/2016 £m	Avg Rate % and Avg Life (yrs)
CFR	275.3				275.3	
Short Term Borrowing[2]	40.5	(18.5)	-	-	22.0	0.67% 0.45 years
Long Term Borrowing - PWLB - Local Authorities	117.9	(8.5)	-	30.0	139.4	4.5% 9.05 years
TOTAL BORROWING	**158.4**	**(27.0)**	-	**30.0**	**161.4**	**3.98% 8.24 years**
Other Long Term Liabilities	69.0				69.0	
TOTAL EXTERNAL DEBT	**227.4**				**230.4**	
Increase/ (Decrease) in Borrowing £m					**3.0**	

LOBOs: The council holds £5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS had options during the half year, none of which were exercised by the lender. As all LOBOS have options during 2016/17, the council acknowledges there is an element of

[2] Loans with maturities less than 1 year.

refinancing risk even though in the current interest rate environment lenders are unlikely to exercise their options.

Debt Rescheduling:

The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

5. Investment Activity

At 30 September 2016, the council holds invested funds of £39.2 million, representing income received in advance of expenditure plus balances and reserves held. These invested funds primarily relate to the additional PWLB borrowing that was undertaken in June in advance of capital expenditure and repayment of existing debt. Cash flow forecasts indicated that during 2016/17 the council's investment balances would range between £0 and £39 million.

The Guidance on Local Government Investments in England gives priority to security and liquidity and the council's aim is to achieve a yield commensurate with these principles.

The transposition of European Union directives into UK legislation places the burden of rescuing failing EU banks disproportionately onto unsecured local council investors through potential bail-in of unsecured bank deposits including certificates of deposit. Please note: the outcome of the EU referendum does not alter the UK's legislated bail-in resolution regime.

Given the increasing risk and continued low returns from short-term unsecured bank investments, it is the council's aim to diversify into more secure and/or higher yielding asset classes. This is especially the case for the estimated £34 million that is available for longer-term investment. All of the council's surplus cash is invested in short-term unsecured bank deposits, Local Authority lending and money market funds.

Half-Yearly Treasury Progress Report 2016/17

Investment Activity in 2016/17

Investments	Balance on 01/04/2016 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 30/09/2016 £m	Avg Rate/Yield (%) and Avg Life (years)
UK Government: - DMADF	-	73.0	(71.7)	1.3	0.15% 0.03 years
Bonds issued by Multilateral Development Banks	-	-	-	-	n/a
Unsecured Investments (call accounts, deposits and CDs) with financial institutions - rated A- or higher	18.7	31.3	(34.6)	15.4	0.67% 0.4 years
- rated below A-	-	19.6	(18.3)	1.3	0.25% 0.00 years
Secured Investments with financial institutions	-	-	-	-	n/a
Investments with Corporates (loans, corporate bonds and commercial paper issued by companies)	-	-	-	-	n/a
Investments with other Local Authorities	6.6	31.5	(24.6)	13.5	0.41% 0.48 years
Money Market Funds	-	39.8	(32.1)	7.7	0.35% 0.00 years
Other Pooled Funds	-	-	-	-	n/a
Investments with Registered Providers of Social Housing	-	-	-	-	n/a
Investments with institutions without credit ratings	-	-	-	-	n/a
Other organisations (e.g. loans to small businesses)	-	-	-	-	n/a
TOTAL INVESTMENTS	**25.3**	**195.2**	**(181.3)**	**39.2**	**0.49% 0.24 years**
Increase/ (Decrease) in Investments £m				13.9	

Security of capital has remained the council's main investment objective. This has been maintained by following the council's counterparty policy as set out in its Treasury Management Strategy Statement for 2016/17.

Counterparty credit quality was assessed and monitored with reference to credit ratings (the council's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A- across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

Credit Risk
The table below shows counterparty credit quality as measured by credit ratings and the percentage of the investment portfolio exposed to bail-in risk.

Date	Value Weighted Average - Credit Risk Score	Value Weighted Average - Credit Rating	Time Weighted Average - Credit Risk Score	Time Weighted Average - Credit Rating	Investments exposed to bail-in risk %
31/03/2016	5.17	A+	4.65	A+	74%
30/06/2016	4.25	AA-	4.13	AA-	55%
30/09/2016	4.52	A+	4.24	AA-	62%

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

At 30 September 2016 the council had an increased level of investments when compared to 31 March 2016. This was due to the £30.0m borrowing from PWLB that was taken at the end of June in advance of the Capital expenditure requirements. The investments we split between UK Banks and Building Societies (39.3%), other Local Authorities (34.3%) and Money Market Funds (19.6%).

Counterparty Update

Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune although the fall in their share prices was less pronounced.

Fitch downgraded the UK's sovereign rating by one notch to AA from AA+, and Standard & Poor's downgraded its corresponding rating by two notches to AA from AAA. Fitch, S&P and Moody's have a negative outlook on the UK. S&P took similar actions on rail company bonds guaranteed by the UK Government. S&P also downgraded the long-term ratings of the local authorities to which it assigns ratings as well as the long-term rating of the EU from AA+ to AA, the latter on the agency's view that it lowers the union's fiscal flexibility and weakens its political cohesion.

Moody's affirmed the ratings of nine UK banks and building societies but revised the outlook to negative for those that it perceived to be exposed to a more challenging operating environment arising from the 'leave' outcome.

There was no immediate change to Arlingclose's credit advice on UK banks and building societies as a result of the referendum result. Our advisor believes there is a risk that the uncertainty over the UK's future trading prospects will bring forward the timing of the next UK recession.

The European Banking Council released the results of its 2016 round of stress tests on the single market's 51 largest banks after markets closed on Friday 29th July. The stress tests gave a rather limited insight into how large banks might fare under a particular economic scenario. When the tests were designed earlier this year, a 1.7% fall in GDP over three years must have seemed like an outside risk. Their base case of 5.4% growth now looks exceptionally optimistic and the stressed case could be closer to reality. No bank was said to have failed the tests. The Royal Bank of Scotland made headline news as one of the worst performers as its ratios fell by some of the largest amounts, but from a relatively high base. Barclays Bank and Deutsche Bank ended the test with Common Equity Tier 1 (CET1) ratios below the 8% threshold, and would be required to raise more capital should the stressed scenario be realised. The tests support our cautious approach on these banks.

Fitch also upgraded Svenska Handelsbanken's long-term rating from AA- to AA reflecting the agency's view that the bank's earnings and profitability will remain strong, driven by robust income generation, good cost efficiency and low loan impairments.

Budgeted Income and Outturn

The average cash balances were £14.8m during the quarter. The UK Bank Rate had been maintained at 0.5% since March 2009 until August 2016, when it was cut to 0.25%. It is now forecast to fall further towards zero but not go negative. Short-term money market rates have remained at relatively low levels (see Table 1 in Appendix 2). Following the reduction in Bank Rate, rates for very short-dated periods (overnight – 1 month) fell to between 0.1% and 0.2%. Debt Management Account Deposit Facility (DMADF) rates fell to 0.15% for periods up to 3 months and to 0.10% for 4 – 6 month deposits.

New investments on an unsecured basis with banks and building societies over the 6-month period were made at an average rate of 0.28% Investments in Money Market Funds generated an average rate of 0.22%

The council's investment income for the year is forecast to be £175,000 against a revised budget of £160,000, having removed the previous investment income target in respect of the Asda capital receipt. Actual investment income includes £31,000 from the loan to the solar energy company, funded from the Asda receipt, and £30,000 on the council's investment in the Lloyds Lend A Hand Mortgage Scheme.

The Bank Rate is expected to be cut further towards zero in the coming months, which will in turn lower the rates short-dated money market investments with banks and building societies. As a substantial proportion of the council's surplus cash continues to be invested in short-dated money market instruments, it will most likely result in a substantial fall in investment income over the year. The deposit rate on the council's deposit account with Svenska Handelsbanken was reduced to 0% (from 0.3%) on 19 August 2016, and the council has received notice that the interest rate on its National Westminster Bank instant access account will reduce to 0% (from 0.25%) on 12 December 2016.

6. Compliance with Prudential Indicators

The council confirms compliance with its Prudential Indicators for 2016/17, which were set in February 2016 as part of the council's Treasury Management Strategy Statement.

Treasury Management Indicators

The council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed will be:

	2016/17	2017/18	2018/19
Upper limit on fixed interest rate exposure	£226.0m	£253.1m	£260.0
Actual	£127.4m		
Upper limit on variable interest rate exposure	£24.1m	£31.2m	£39.1m
Actual	£34.0m		

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

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

	Upper	Lower	Actual
Under 12 months	30%	0%	21%
12 months and within 24 months	10%	0%	2%
24 months and within 5 years	20%	0%	9%
5 years and within 10 years	50%	0%	22%
10 years and above	95%	0%	46%

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

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

	2016/17	2017/18	2018/19
Limit on principal invested beyond year end	£34m	£41m	£38m
Actual	-	-	-

Security: The council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average [credit rating] or [credit score] of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual 30/9/2016
Portfolio average credit score	6.0	4.24

Liquidity: The council addresses liquidity issues by restricting a significant proportion of its investment opportunities to short term and instant access deposits. At 30 September 2016, approximately 61% of the council's investments matured within 3 months.

The following two prudential indicators are relevant to the treasury function as they concern limits on borrowing and the adoption of the CIPFA Treasury Management Code.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt.

Operational Boundary	2016/17 £m	2016/17 Actual £m	2017/18 £m	2018/19 £m
Borrowing	190.0	**161.4**	200.0	220.0
Other long-term liabilities	102.0	**69.0**	107.0	101.0
Total Debt	**292.0**	**230.4**	**307.0**	**321.0**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2016-17 £m	2016/17 Actual £m	2017/18 £m	2018/19 £m
Borrowing	252.0	**161.4**	257.0	273.0
Other long-term liabilities	102.0	**69.0**	107.0	101.0
Total Debt	**354.0**	**230.4**	**307.0**	**321.0**

Adoption of the CIPFA Treasury Management Code: The council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in February 2003.

7. Investment Training

In the period since her appointment in January 2016, the Pension Fund and Treasury Management Accountant has attended the CIPFA Introduction to Treasury Management event, briefing sessions and networking events from the council's treasury management software providers (Logotech) and from the treasury management advisers (Arlingclose Limited).

On 7 October 2016, the Treasury Management Assistant retired from employment with the council after 42 years' service. On consideration, his duties have been subsumed within the role of an accountancy assistant within the financial management team, who will be acting on instruction from the Pension Fund and Treasury Management Accountant and the Technical Finance Manager, within the boundaries of the approved Treasury Management Strategy.

8. Outlook for the remainder of 2016/17

The economic outlook for the UK has immeasurably altered following the popular vote to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU, particularly with regard to Single Market access.

The short to medium-term outlook as been more downbeat due to the uncertainty generated by the result and the forthcoming negotiations. Economic and political uncertainty will likely dampen or delay investment intentions, prompting lower activity levels and potentially a rise in unemployment. The downward trend in growth apparent on the run up to the referendum may continue through the second half of 2016, although some economic data has held up better than was initially expected, perhaps suggesting a less severe slowdown than feared.

Arlingclose has changed its central case for the path of Bank Rate over the next three years. Arlingclose believes any currency-driven inflationary pressure will be looked through by Bank of England policymakers. Arlingclose's central case is for Bank Rate to remain at 0.25%, but there is a 40% possibility of a drop to close to zero, with a small chance of a reduction below zero.

Gilt yields are forecast to be broadly flat from current levels, albeit experiencing short-term volatility.

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

Global interest rate expectations have been pared back considerably. There remains a possibility that the Federal Reserve will wait until after November's presidential election, and probably hike interest rates in in December 2016 but only if economic conditions warrant.

In addition, Arlingclose believes that the Government and the Bank of England have both the tools and the willingness to use them to prevent market-wide problems leading to bank insolvencies. The cautious approach to credit advice means that the banks currently on the council's counterparty list have sufficient equity buffers to deal with any localised problems in the short term.

Appendix 1

Prudential Indicators 2016/17

The Local Government Act 2003 requires the council to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The council's planned capital expenditure and financing may be summarised as follows. Further detail is provided Appendix B of the council's "Medium Term Budget Strategy 2016-17 and 2017-18 and Council Tax Setting 2016-17" paper presented to full council on 24 February 2016

Capital Expenditure and Financing	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
General Fund				
Total Expenditure	**21.9**	**37.1**	**39.5**	**18.2**
Capital Receipts	0.7	4.2	0.0	0.0
Government Grants	5.4	13	6.7	4.6
Reserves	0.0	0.0	0.4	8.6
Revenue	0.0	0.0	0.0	0.0
Borrowing	15.8	19.9	32.4	5.0
Leasing and PFI	0.0	0.0	0.0	0.0
Total Financing	**21.9**	**37.1**	**39.5**	**18.2**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.16 Actual £m	31.03.17 Estimate £m	31.03.18 Estimate £m	31.03.19 Estimate £m
General Fund	275.3	**310.8**	353.8	363.6
Total CFR	**275.3**	**310.8**	**353.8**	**363.6**

The CFR is forecast to rise by £88.3m over the next three years due to significant capital investment within the waste contract, and as historic capital expenditure financed by debt outweighs resources put aside for debt repayment, principally as a result of the Highways PFI project.

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

Debt	31.03.16 Actual £m	30.03.17 Estimate £m	31.03.18 Estimate £m	31.03.19 Estimate £m
Borrowing	154.4	150.4	174.8	184.4
Finance leases	0.6	**0.2**	0.1	0.1
PFI liabilities	68.4	**85.0**	101.5	106.7
Total Debt	**227.4**	**235.6**	**276.4**	**291.2**

Total debt is expected to remain below the CFR during the forecast period.

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

Operational Boundary for External Debt: The Operational Boundary is based on the council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary	2016/17 £m	2017/18 £m	2018/19 £m
Borrowing	**190.0**	200.0	220.0
Other long-term liabilities	**102.0**	107.0	101.0
Total Debt	**292.0**	**307.0**	**321.0**

The council confirms that during 2016/17, the Operational Boundary was not breached.

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Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2016/17 £m	2017/18 £m	2018/19 £m
Borrowing	**252.0**	257.0	273.0
Other long-term liabilities	**102.0**	107.0	101.0
Total Debt	**354.0**	**364.0**	**374.0**

Total debt at 30/9/2016 was £161.4m. The council confirms that during 2016/17 the Authorised Limit was not breached at any time.

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
General Fund	15.1	22.5	32.0

Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £
General Fund - increase in annual Band D Council Tax	**3.35**	11.45	28.87

Adoption of the CIPFA Treasury Management Code: The council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in February 2003.

Appendix 2

Money Market Data and PWLB Rates

The average, low and high rates correspond to the rates during the financial year rather than those in the tables below.

Please note that the PWLB rates below are Standard Rates. Authorities eligible for the Certainty Rate can borrow at a 0.20% reduction.

Table 1: Bank Rate, Money Market Rates

Date		Bank Rate		O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/4/2016		0.50		0.36	0.36	0.39	0.46	0.61	0.88	0.78	0.83	0.98
30/4/2016		0.50		0.36	0.36	0.38	0.47	0.62	0.90	0.86	0.95	1.13
31/5/2016		0.50		0.35	0.37	0.39	0.46	0.61	0.89	0.82	0.92	1.09
30/6/2016		0.50		0.35	0.36	0.39	0.43	0.55	0.80	0.49	0.49	0.60
31/7/2016		0.50		0.15	0.45	0.42	0.52	0.64	0.77	0.47	0.47	0.54
31/8/2016		0.25		0.11	0.18	0.18	0.38	0.54	0.69	0.42	0.42	0.48
30/9/2016		0.25		0.10	0.25	0.45	0.51	0.61	0.74	0.43	0.42	0.47
Minimum		0.25		0.02	0.15	0.18	0.30	0.50	0.66	0.38	0.37	0.42
Average		0.43		0.26	0.37	0.42	0.52	0.66	0.83	0.61	0.64	0.75
Maximum		0.50		0.43	0.55	0.61	0.72	0.83	1.04	0.88	0.99	1.20
Spread		0.25		0.41	0.40	0.43	0.42	0.33	0.38	0.51	0.62	0.78

Table 2: PWLB Borrowing Rates - Fixed Rate, Equal Instalment of Principal (EIP) Loans (Standard Rate)

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/4/2016	125/16	1.50	1.86	2.54	2.99	3.25	3.34
30/4/2016	165/16	1.59	1.99	2.68	3.11	3.34	3.42
31/5/2016	205/16	1.58	1.97	2.58	2.99	3.23	3.30
30/6/2016	249/16	1.24	1.51	2.11	2.55	2.79	2.86
31/7/2016	292/16	1.13	1.34	1.87	2.31	2.58	2.67
31/8/2016	336/16	1.12	1.25	1.67	2.02	2.23	2.31
30/9/2016	380/16	1.05	1.22	1.72	2.13	2.36	2.44
	Low	1.03	1.17	1.64	2.00	2.20	2.28
	Average	1.30	1.57	2.15	2.58	2.82	2.89
	High	1.63	2.04	2.73	3.17	3.41	3.48