BROMSGROVE DISTRICT COUNCIL

AUDIT BOARD

19th March 2015

TREASURY MANAGEMENT STRATEGY STATEMENT AND INVESTMENT STRATEGY 2014-15 TO 2016-17

Relevant Portfolio Holder Portfolio Holder Consulted Relevant Head of Service	Cllr Mike Webb Jayne Pickering
Wards Affected	All
Ward Councillor Consulted	None specific
Non-Key Decision	

1. SUMMARY OF PROPOSALS

1.1 Members are asked to approve the strategy statement for treasury management and investments in order to comply with the Local Government Act 2003.

2. RECOMMENDATIONS

2.1 Audit Board to approve:

2.1.1 the Strategy and Prudential Indicators shown at Appendix 1.

2.1.2 the Authorised Limit for borrowing at £12 million if required.

2.1.3 the maximum level of investment to be held within each organisation (i.e. bank or building society) as detailed at £3 million, subject to market conditions.

2.1.4 an unlimited level for investment in Debt Management Account Deposit Facility (DMADF).

2.1.5 the updated Treasury Management Policy shown at Appendix 2, and

3. KEY ISSUES

Financial Implications

3.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public services (the CIPFA TM Code) and the Prudential Code require local authorities to set the Treasury

Management Strategy Statement (TMSS) and Prudential Indicators each financial year. The TMSS also incorporates the Investment Strategy as required under the CLG's Investment Guidance.

3.2 CIPFA has defined Treasury Management as:

"the management of the organisation's investments, 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."

3.3 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Treasury management risks are identified in the Council's approved Treasury Management Practices and include:

- Liquidity Risk (Adequate cash resources)
- Market or Interest Rate Risk Fluctuations in the value of investments).
- Inflation Risks (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risks (Impact of debt maturing in future years).
- Legal & Regulatory Risk (Compliance with statutory and regulatory requirements

3.4 In addition the Local Government Act 2003 requires the Council to 'have regard to the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable'.

3.5 The revised CLG guidance issued in November 2011 makes it clear that investment priorities should be security and liquidity, rather than yield and that authorities should not rely just on credit ratings, but consider other information on risk.

3.6 The guidance requires investment strategies to comment on the use of treasury management consultants and on the investment of money borrowed in advance of spending needs.

3.7 In formulating the Treasury Management Strategy and the setting of the Prudential Indicators, the Council adopts the Treasury Management Framework and Policy recommended by CIPFA.

Legal Implications

3.8 This is a statutory report under the Local Government Act 2003.

Service/Operational Issues

3.9 None as a direct result of this report.

Customer/ Equalities and Diversity

3.10 None as a direct result of this report.

4. RISK MANAGEMENT

4.1 Failure to manage the Treasury Management function effectively to ensure the delivery of maximum return within a secure environment. These controls in place to mitigate these risks are as follows:

- Quarterly reporting to Overview and Scrutiny Committee and Audit Board of financial position on investments
- Regular monitoring of the status of the organisations we invest with
- Daily monitoring by internal officers of banking arrangements and cash flow implications.

5. APPENDICES

Appendix 1 - Treasury Management Strategy Statement and Investment Strategy 2015/16
Appendix 2 – Treasury Management Policy Statement

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Appendix 1

Treasury Management Strategy Statement
And
Investment Strategy
2015/16

1. Introduction

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the CLG's Investment Guidance.

1.2 The purpose of this TMSS is, therefore, to approve:
- Treasury Management Strategy for 2015/16
- Annual Investment Strategy for 2015/16
- Prudential Indicators for 2015/16, 2016/17 and 2017/18
- MRP Statement.

1.3 Treasury Management is about the management of risk. The Authority is responsible for its treasury decisions and activity. No treasury management activity is without risk.

1.4 In accordance with the requirements of the Prudential Code, the Authority has adopted the CIPFA Treasury Management Code at a meeting of the Council on 17th March 2010.

1.5 All treasury activity will comply with relevant statute, guidance and accounting standards.

2. Background

2.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with Usable Reserves, are the core drivers of the Authority's Treasury Management activities.

2.2 The Authority's currently has no external debt and £9.9 million in short term investments.

2.3 The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level in 2015/16. The Authority is likely to only borrow in advance of need if it felt the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing was actually required.

2.4 The forecasted movement in the CFR in coming years is one of the Prudential Indicators (PIs). The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years.

Table 1: Balance Sheet Summary Analysis

	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
CFR	2,404	8,042	4,137	(929)
Balances & Reserves	5,424	1,229	102	(3,422)
Cumulative Net Borrowing Requirement/(Investments)	**(3,020)**	**6,813**	**4,035**	**(2,493)**

2.5 Table 1 shows that the capital expenditure plans of the Authority cannot be funded entirely from sources other than external borrowing.

3. Interest Rate Forecast

3.1 The economic and interest rate forecast provided by the Authority's treasury management advisor is attached. The Authority will reappraise its strategies from time to time in response to evolving economic, political and financial events.

4. Borrowing Strategy

4.1 Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short and long term interest rates. The interest rate forecast provided indicates that an acute difference between short and longer term interest rates is expected to continue. This difference creates a "cost of carry" for any new longer term borrowing where the proceeds are temporarily held as investments because of the difference between what is paid on the borrowing and what is earned on the investment. Whilst the cost of carry can be assumed to be a reasonably short-term issue since borrowing is often for longer dated periods (anything up to 50 years) it cannot be ignored against a backdrop of uncertainty and affordability constraints in the Authority's wider financial position.

4.2 The Authority has a gross and net borrowing requirement 2015/16 onwards as indicated in Table 1. The Authority will adopt a flexible approach to this borrowing. The following issues will be considered prior to undertaking any external borrowing:

- Affordability;
- Maturity profile of existing debt;
- Interest rate and refinancing risk;
- Borrowing source.

5. Sources of Borrowing and Portfolio implications

5.1 The Authority will keep under review the following borrowing sources:

- PWLB
- Local authorities
- Commercial banks
- European Investment Bank
- Money markets
- Capital markets (stock issues, commercial paper and bills)
- Structured finance
- Leasing

6. Annual Investment Strategy

6.1 In accordance with Investment Guidance issued by the CLG and best practice, this Authority's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yields earned on investments is important but are secondary considerations.

6.2 Credit markets remain in a state of distress as a result of the excessive and poor performing debt within the financial markets. In some instances, Greece and Italy being the most notable examples, the extent and implications of the debt it has built up have lead to a sovereign debt crisis and a banking crisis with the outcome still largely unknown. It is against this backdrop of uncertainty that the Authority's investment strategy is framed.

6.3 Investments are categorised as "Specified" or "Non-Specified" within the investment guidance issued by the CLG. Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the "high credit quality" as determined by the Authority and are not deemed capital expenditure investments under Statute. Non specified investments are, effectively, everything else.

6.4 The types of investments that will be used by the Authority and whether they are specified or non-specified are as follows:

Table 2: Specified and Non-Specified Investments

Investment	Specified	Non-Specified
Term deposits with banks and building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Certificates of deposit with banks and building societies	✓	✓
Gilts	✓	✓
Treasury Bills (T-Bills)	✓	×
Bonds issued by Multilateral Development Banks	✓	✓
Local Authority Bills	✓	×
Commercial Paper	✓	×
Corporate Bonds	✓	✓
Money Market Funds	✓	×
Other Money Market and Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	×

6.5 A number of changes were implemented to the investment strategy for 2012/13 in response to changes in the CLG Guidance and evolving conditions in financial markets. These resulted in the inclusion of corporate bonds which the CLG indicated would become an eligible non-capital investment from 1st April 2012. A number of amendments were also made in relation to the individual institutions with which the Authority is prepared to lend its funds.

6.6 The Authority will select countries and financial institutions after analysis and ongoing monitoring of:

- Published credit ratings for financial institutions (minimum long term rating of A- or equivalent for counterparties; AA+ or equivalent for non-UK sovereigns) – this is lower than the A+ minimum adopted in 2011/12 and is in response to downgrades in credit ratings below A+ of many institutions considered to be systemically important to the financial system.
- Credit Default Swaps (where quoted)
- Economic fundamentals (for example Net Debt as a percentage of GDP)
- Sovereign support mechanisms
- Share Prices
- Corporate developments, news, articles, markets sentiment and momentum
- Subjective overlay – or, put more simply, common sense.

Any institution can be suspended or removed should any of the factors identified above give rise to concern.

It remains the Authority's policy to make exceptions to counterparty policy established around credit ratings, but this is conditional and directional. What this means is that an institution that meets criteria may be suspended, but institutions not meeting criteria will not be added.

6.7 **Authority's Banker** – The Authority banks with HSBC. At the current time, it *does* meet the minimum credit criteria of A- (or equivalent) long term. *Even if the credit rating falls* below the Authority's minimum criteria HSBC will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

6.8. **Promoting Economic Development**

Loans for Small and Medium Enterprises (SMEs) – Subject to Audit Board approval, under this scheme the Council may loan up to £1million through a Bromsgrove Business Loans Fund administered by Finance Birmingham to SMEs which have been refused funding from banks. This is classified as being a service investment, rather than treasury management investment, and is therefore outside of the Specified/Non specified categories.

7. Investment Strategy

7.1 With short term interest rates low for even longer, an investment strategy will typically result in a lengthening of investment periods, where cash flow permits, in order to lock in higher rates of acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of counterparty risk.

7.2 In order to diversify an investment portfolio largely invested in cash, investments will be placed with a range of approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return. The maximum investment level with each counterparty will be set to ensure prudent diversification is achieved.

7.3 Money market funds (MMFs) will be utilised but good treasury management practice prevails and whilst MMFs provide good diversification the Authority will also seek to diversify any exposure by utilising more than one MMF. The Authority will also restrict its exposure to MMFs with lower levels of funds under management and will not exceed 0.5% of the net asset value of the MMF. In the case of Government MMFs, the Council will ensure exposure to each Fund does not exceed 2% of the net asset value of the Fund.

8. The Use of Financial Instruments for the Management of Risks

8.1 Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the authority does not intend to use derivatives.

8.2 Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require full Council approval.

9 Balanced Budget Requirement

9.1 The Authority complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

10. 2015/16 MRP Statement

10.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

10.2 The broad aim of "prudent provision" is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of the grant. This Authority does not have any borrowing supported by Revenue Support Grant.

10.3. MRP is calculated in the financial year after the capital expenditure has been incurred and so the capital spend in 2014/15 informs the MRP set aside in the revenue account for 2015/16. The new regulations have added an exception to this in that if expenditure has been incurred on an asset which has not become operational then MRP does not need to be set aside until the financial year after the asset becomes operational. In effect authorities are entitled to a "MRP holiday" until the new asset becomes operational.

10.4 MRP in respect of leases that have been brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

11. Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

11.1 The Executive Director of Finance and Corporate Resources will report to Audit Board on treasury management activity / performance and Performance Indicators as follows:

- Quarterly against the Strategy approved for the year. The Authority will produce an outturn report on its treasury activity no later than 30th September after the financial year end.
- The Audit Board will be responsible for the scrutiny of treasury management activity and practices.

12. Other Items

12.1 Training

CIPFA's Code of Practice requires the Executive Director of Finance and Corporate Resources to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Responsibility for scrutiny of the Treasury Management function will rest with the Audit Board. The Executive Director of Finance and Corporate Resources will ensure that adequate training is provided for all relevant Members during the Financial Year.

12.2 Investment Consultants/Treasury Advisors

The CLG's Guidance on local government investments recommend that the Investment Strategy should state:

- Whether and, if so, how the authority uses external contractors offering information, advice or assistance relating to investment and
- How the quality of any such service is controlled.

The Council currently uses external consultants, Arlingclose for information and advice relating to investments. Updated information is received and monitoring undertaken by regular meetings and reports between the Executive Director of Finance and Resources and representatives from Arlingclose.

AUDIT BOARD

19th March 2015

Prudential Indicators 2015/16 – 2017/18

1 Background:

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

2. Net Borrowing and the Capital Financing Requirement:

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

The Executive Director of Finance and Corporate Resources reports that the authority had no difficulty meeting this requirement in 2014/15, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3. Estimates of Capital Expenditure:

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

Capital Expenditure	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
General	5,516	11,380	5,798	1,592
Total	**5,516**	**11,380**	**5,798**	**1,592**

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Capital receipts	1,746	2,900	1,015	1,700
Government Grants	363	315	315	315
Section 106	908	0	0	0
Other contributions	95	123	331	506
Total Financing	3,112	3,338	1,661	2,521
Unsupported borrowing	2,404	8,042	4,137	-929
Total Funding	2,404	8,042	4,137	-929
Total Financing and Funding	**5,516**	**11,380**	**5,798**	**1,592**

4. Capital Financing Requirement:

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

Capital Financing Requirement	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
General Fund	2,404	8,042	4,137	-929
Total CFR	**2,404**	**8,042**	**4,137**	**-929**

5. Actual External Debt:

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

Actual External Debt as at 31/03/2014	£'000
Borrowing	80
Other Long-term Liabilities	0
Total	**80**

6. Authorised Limit and Operational Boundary for External Debt

6.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

6.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

6.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

6.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Authorised Limit for External Debt	**2014/15 Estimate £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
Borrowing	3,500	12,000	15,000	15,000
Other Long-term Liabilities	0.0	0.0	0.0	0.0
Total	**3,500**	**12,000**	**15,000**	**15,000**

6.5 The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

6.6 The Executive Director of Finance and Corporate Resources has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of Audit Board.

Operational Boundary for External Debt	**2013/14 Estimate £'000**	**2014/15 Estimate £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**
Borrowing	2,500	11,000	14,000	14,000
Other Long-term Liabilities	0	0	0	0
Total	**2,500**	**11,000**	**14,000**	**14,000**

7. Adoption of the CIPFA Treasury Management Code

7.1 This indicator demonstrates that the Council has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 18th May 2005.

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

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

8.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on *(select as appropriate)* net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments / net interest paid (i.e. interest paid on fixed rate debt net of interest received on fixed rate investments)

8.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments

	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %
Upper Limit for Fixed Interest Rate Exposure	100	100	100	100
Upper Limit for Variable Interest Rate Exposure	100	100	100	100

8.3 As the Council does not have long-term debt, the limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's Treasury Management Strategy.

9. Maturity Structure of Fixed Rate borrowing:

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

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

Maturity structure of fixed rate borrowing	Lower Limit for 2015/16 %	Upper Limit for 2015/16 %
under 12 months	0.00	100.00
12 months and within 24 months	0.00	100.00
24 months and within 5 years	0.00	100.00
5 years above	0.00	100.00

As the Council does not have long-term debt, the limits above provide the necessary flexibility within which decisions will be made for drawing down new loans, should it be necessary, in the appropriate maturity band.

10. Credit Risk:

10.1 The Council considers security, liquidity and yield, in that order, when making investment decisions.

10.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

10.3 The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP);
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.

10.4 The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

11. Upper Limit for total principal sums invested over 364 days:

11.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

Upper Limit for total principal sums invested over 364 days	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m
	2.0	2.0	2.0	2.0

Arlingclose Economic & Interest Rate Forecast (January 2015)

Underlying assumptions:

- The UK economic recovery slowed towards the end of 2014, with economic and political uncertainty weighing on business investment. However, the Q3 growth rate of 0.7% remains slightly above the long run average, suggesting the recovery remains robust.
- Household consumption is key to the recovery in 2015. While we expect consumption growth to slow, given softening housing market activity and slower employment growth, the fall in inflation and resulting rise in both real (and nominal) wage growth and disposable income should support spending.
- Inflationary pressure is currently low (annual CPI is currently 0.5%) and is likely to remain so in the short-term. The fall in oil prices has yet to feed fully into the prices of motor fuel and retail energy and CPI is expected to fall further. Supermarket price wars are also expected to bear down on food price inflation.
- The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee.
- Nominal earnings growth is strengthening, but remains relatively weak in historical terms, despite large falls in unemployment. Our view is that spare capacity remains extensive. The levels of part-time, self-employment and underemployment are significant and indicate capacity within the employed workforce, in addition to the still large unemployed pool. Productivity growth can therefore remain weak in the short term without creating undue inflationary pressure.
- However, we also expect employment growth to slow as economic growth decelerates. This is likely to boost productivity, which will bear down on unit labour costs and inflationary pressure.
- In addition to the lack of wage and inflationary pressures, policymakers are evidently concerned about the bleak prospects for the Eurozone. These factors will maintain the dovish stance of the MPC in the medium term. The MPC clearly believes the appropriate level for Bank Rate for the post-crisis UK economy is significantly lower than the previous norm. We would suggest this is between 2.5 and 3.5%.
- The ECB has introduced outright QE as expected. While this may alleviate some of the anxiety about the economic potential of the Eurozone, political risk remains significant (e.g. Greek election). Therefore fears for the Eurozone are likely to maintain a safe haven bid for UK government debt.

Forecast:

- We continue to forecast the first rise in official interest rates in Q3 2015, but the risks to this forecast are very much weighted to the downside. The February Inflation Report will be key to our review of the possible path for Bank Rate.
- We project a slow rise in Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited; we believe the normalised level of Bank Rate post-crisis to range between 2.5% and 3.5%.
- Market sentiment (derived from forward curves) has shifted significantly lower in the past three months; market expectations are now for a later increase in interest rates and a more muted increase in gilt yields.
- The short run path for gilt yields has flattened due to the sharp decline in inflation expectations. We project gilt yields on an upward path in the medium term.
- The short run path for gilt yields is flatter due to the deteriorating Eurozone situation. We project gilt yields on an upward path in the medium term.

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Official Bank Rate													
Upside risk				0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.50**	**1.50**	**1.75**	**1.75**	**1.75**
Downside risk			0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00
3-month LIBID rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	**0.55**	**0.60**	**0.80**	**0.90**	**1.05**	**1.15**	**1.30**	**1.40**	**1.55**	**1.65**	**1.80**	**1.95**	**2.00**
Downside risk	0.15	0.20	0.30	0.40	0.55	0.65	0.75	0.85	0.95	0.95	0.95	0.95	1.00
1-yr LIBID rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.30	0.30	0.30	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**0.95**	**1.00**	**1.20**	**1.30**	**1.45**	**1.55**	**1.70**	**1.80**	**1.95**	**2.05**	**2.20**	**2.35**	**2.40**
Downside risk	0.15	0.20	0.30	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.80	0.80	0.80
5-yr gilt yield													
Upside risk	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50
Arlingclose Central Case	**1.10**	**1.20**	**1.30**	**1.40**	**1.50**	**1.65**	**1.80**	**1.95**	**2.10**	**2.20**	**2.35**	**2.40**	**2.50**
Downside risk	0.35	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65	0.70	0.70	0.70	0.75
10-yr gilt yield													
Upside risk	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50	0.55	0.55
Arlingclose Central Case	**1.60**	**1.70**	**1.80**	**1.90**	**2.00**	**2.15**	**2.30**	**2.45**	**2.60**	**2.70**	**2.85**	**2.90**	**3.00**
Downside risk	0.35	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65	0.70	0.70	0.75	0.80
20-yr gilt yield													
Upside risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	**2.10**	**2.20**	**2.30**	**2.35**	**2.45**	**2.50**	**2.65**	**2.75**	**2.90**	**3.00**	**3.15**	**3.20**	**3.30**
Downside risk	0.35	0.40	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.85	0.85	0.90	0.90
50-yr gilt yield													
Upside risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	**2.15**	**2.25**	**2.35**	**2.40**	**2.50**	**2.55**	**2.70**	**2.80**	**2.95**	**3.05**	**3.20**	**3.25**	**3.35**
Downside risk	0.35	0.40	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.85	0.85	0.90	0.90

Appendix 2

TREASURY MANAGEMENT POLICY STATEMENT

1. INTRODUCTION AND BACKGROUND

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council (i.e. full Council) will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Audit Board and for the execution and administration of treasury management decisions to Executive Director of Finance and Resources, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates Audit Board to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies.

2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

2.1 The Council defines its treasury management activities as:

"The management of the Council'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."

2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management."

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.